ECONOMIC DOCTRINES

OF ISLAM

Vol. III

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بسم الله الرحمن الرحيم

PREFACE

All praise be to Allah, Most Gracious, Most Merciful. We seek His help and guidance in all our practical problems in life. Peace and blessings of Allah be on His Last Messenger who has shown us the right way through the darkness of ignorance and kufr.

With the help of Allah, we present the Third Volume of our book, *Economic Doctrines of Islam* to our readers. In this volume we have discussed the various aspects of the concepts of interest and Zakat and we hope the readers will find some very useful and interesting suggestions on these topics.

I humbly admit that I am not properly equipped with adequate knowledge of Mathematics and Statistics and, therefore, have not been able to do full justice to the subject, especially the statistical aspect of interest and Zakat but I hope that someone with greater knowledge of these subjects will have the opportunity to work on this aspect of interest and Zakat and succeed in showing its enormous benefits to humanity which I have failed to unfold.

May Allah forgive my shortcomings. Ameen !

Ilford, Essex, (U.K.)
21 July, 1975.

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INTRODUCTION

The Economic system of Islam is a great blessing for humanity. If it is implemented thoroughly and in the right spirit, it is bound to satisfy every reasonable need of the society. It will be the most useful, just and rational system for the economic betterment of humanity. However, it is absolutely necessary for its successful operation that it must be based on the ideology and moral teachings of Islam. It has a very deep and intimate relationship with the ethical, ideological and cultural teachings of Islam and, therefore, must not be separated from its ethical basis. Multifarious advantages would accrue to society if it adopts the system as a whole in its wider context.

Under the economic system of Islam, the individual and the social good are regarded as complementary rather than contradictory and antagonistic and a very close relationship is fostered between them. Welfare of the individual reflects the welfare of society and vice versa. If society prospers, the individuals prosper and if the individuals are better off, society is better off.

The individuals try to meticulate complete harmony between their personal good and the good of society merely to win the favour of God. They would never intend to do any harm, directly or indirectly, to any member of society or endanger their common welfare. If they benefit themselves they also let other individuals and society share that benefit ; so much so that if they cannot personally derive any benefit from any enterprise, they would undertake it simply for the sake of others so that society may benefit from it.

Under this system, neither few individuals can become the custodians of the national wealth of the community nor all the individuals are forcibly brought to the same economic level. Healthy conditions are created in the community so as to enable individuals to earn and spend their wealth for the satisfaction of their wants without endangering the welfare of their fellow

men. As the individuals spend their income most economically keeping in view the best interest of society, the stability and balance of the economic system is rarely disturbed.

The foundation of the system is laid on high moral qualities of obedience to God, co-operation, brotherhood, fraternity, generosity and love for fellow beings. The growth of such high moral qualities among the members of the community greatly helps to foster and maintain balance in economic life. Therefore, "far greater stress is laid on moral reformation and the creation of the right moral attitude" among people to achieve the above-mentioned objectives. "The authority and pressure of law and the coercive power of Government" are used only when it becomes absolutely necessary to do so.[1] And even that is done to achieve the minimum required objectives.

In order to develop and foster these high qualities among people Islam has laid, inter alia, a code of expenditure for surplus wealth. It suggests that the surplus wealth should be utilized in the pursuit of virtue, righteousness, public welfare and in rendering assistance to persons who have been unable to secure their due share to meet their needs. The best course for people who have surplus wealth is to hand it over to the needy. This quality is regarded as one of the highest tenets of morality in Islam. And Islamic society always respects those who earn and spend rightly much more than those who keep their wealth hoarded or who go on investing their surplus incomes in earning more and more.[2]

Economic policy of Islam is perfectly in line with its basic philosophy and its general scheme of life. It adopts the most suitable and perfectly balanced economic policy keeping in view the welfare of the individual as well as of society. It neither encroaches upon the rights of individuals nor does it endanger the good of society.

And in order to achieve its objectives successfully it has adopted the moral as well as legal measures. With the help of legal

1. Sayyid A. A. Maududi, *Economic Problem of Man and its Islamic Solution*, p. 46.
2. *Ibid.*, p. 51.

measures it is able to achieve its practical objectives which are by themselves quite sufficient for the development of a progressive society. Moral teachings help people to rise above the level of material wants, to appreciate the higher values of life and to advance towards the nobler objectives of public good and social justice.

Moral Teachings

The Islamic Law merely takes a certain portion (not whole) of the wealth of the rich and does not go beyond a certain limit. But moral education achieves much wider results and infuses such a spirit among people that they are prepared to dispose of all their wealth for the will of God. There are many verses in the Qur'an which infuse this spirit among people and encourage them to spend their wealth on the poor. At one place, it is said :

> "O you who believe ! Give of the good things which you have (honourably) earned, and of the fruits of the earth which We have produced for you, and do not even aim at getting anything which is bad, in order that out of it you may give away someting, when you yourselves would not receive it except with closed eyes (i.e., with disgust)."
> **(2 : 267)**

This verse makes it clear that charity has value only if something good and valuable is given out of one's honourably earned income or out of the Bounty of God (i.e. wealth produced in Nature).

The Holy Prophet laid great emphasis on this aspect of private expenditure and condemned those who did not help the poor members of the community.

(It is reported that) the Holy Prophet said that "it did not benefit a *Mo'min* (i.e. a believer) to sleep with his stomach full while his neighbour was hungry."

The Holy Prophet also said that "any one who turned away a hungry beggar from his doorsteps would be asked by God on the Day of Judgement : "O son of Adam ! I begged food from you but you refused to give me food."

To encourage private expenditure in this way, the Holy Qur'an says that the poor have a right in the wealth of the rich:

"And in their wealth there is the right (due share) of the poor and the needy." (51 : 19)

This verse speaks of the poor having a share in the wealth of the rich. Practically it means that the state has the right to take that share from the rich and give it over to the poor. In fact it gives the community the right to take some portion of the wealth of the rich besides Zakat[1] in order to safeguard the interests of the poor members.

There is a Hadith of the Holy Prophet which emphasises that there are rights (of human beings and God) on the wealth (of the rich) even after the payment of compulsory levy of Zakat. Abu Dhar (a celebrated companion of the Holy Prophet) reports that the Holy Prophet once said :

"That people who did not spend like this (pointing with his hands) were the losers".

Abu Dhar believed that the poor members of society had rightful share in the wealth of the rich and that the payment of Zakat was not enough to absolve them of their duty to help the former in their straitened circumstances.

Islam condemns interest but at the same time creates conditions in society so that interest-free loans are available to people in need. Even the poor debtor is given respite in his financial difficulties as stated in sura Baqara :

"If the debtor is in difficulty, grant him time till it is easy for him to repay. But if you remit it by way of charity, that is best for you if you only knew." (2 : 280)

There are many sayings of the Holy Prophet which encourage people to grant interest-free loans to other fellow human beings. The Holy Prophet is reported to have said :

1. May God have mercy and blessing upon a man who is kind-hearted and generous in his dealings and behaves gently in demanding his loans.

1. See Chapter 14.

2. One who wishes to be safe from pain and suffering on the Day of Judgement, should remove the hardships of a destitute debtor or should lessen his demands on him.
3. One who gives time to a destitute debtor or reduces some capital from his loan, would be under the protection of God when there would be no other protection.
4. The upper hand (one who gives) is better than the lower hand (one who receives).

Legal Measures

Islam has no doubt fostered the spirit of (INFAQ) private expenditure (in the way of God) through moral teachings but it has also taken certain effective legal steps to maintain the propensity to consume at the required level corresponding to full employment. It is true that moral education encourages people to spend more and more in ways seeking the favour of God. The more the people have understood and imbibed the spirit of Islam, the more will they spend for the betterment of the poor merely to win the favour of God.

This type of education helps a great deal in increasing private expenditure on the uplift of the poor and, thereby boosting the level of consumption but this may not provide complete cure for all the ills of society. Because "in spite of all moral education and the exercise of moral pressure of a reformed society, it is not possible to get rid of individual tendencies towards greed and profit-making. A good many people will always remain who like to invest their surplus wealth to make some more wealth **over and above their needs**". In order to check this tendency, Islam has placed some legal limitations on the use of surplus wealth.

Firstly, it strictly prohibits lending of accumulated savings on interest. People are free to save as much as they like but their accumulated savings would not grow on interest in the economic system of Islam.

Secondly, hoarding of the accumulated wealth is not permitted. You must spend whatever wealth you possess in the purchase of your own necessaries of life and hand over the sur-

plus to others for the satisfaction of their needs and thus keep the whole of the accumulated wealth of the community in constant circulation. But if you do not do this and insist on its accumulation, then you must pay Zakat levy at the rate of 2½ per cent per annum on your accumulated wealth for the benefit of the poor and the needy in the community.[1]

The Public Exchequer collects Zakat from the wealthy and distributes it among the poor members of the community who need and deserve help. This is in fact the best form of insurance for society. It destroys all those evils which result from the absence of any regular arrangements for collective help and co-operation. Zakat levy, by providing means of livelihood to the needy and the destitute, helps in increasing their purchasing power and, thereby, in expanding trade, industry and agriculture, in short, every branch of economic activity in the community.[2] Thus a proper balance between production and consumption is permanently maintained in an Islamic society which keeps it free from the evils of trade cycles and slumps.

Thirdly, the Law of Inheritance helps in diffusing wealth concentrated in a few hands among hundreds and thousands in the community. All the wealth which a person had been confining in his hands by gradual accumulation from all sides, in spite of Zakat levy and private expenditure (Infaq), is apportioned among his heirs-males and females, immediately after his death.[3] The Law of Inheritance is explained in the Holy Qur'an in these words :

> "For men is the share of what the parents and the near relatives leave, and for women a share of what the parents and the near relatives leave, whether it be little or much—an appointed share." (4 : 7)

"Under the Islamic Law, sons, daughters, fathers, mothers, wives, brothers, sisters, all of them succeed to a person's inheritance which must be apportioned among all of them according to a definite code. If near relatives do not exist, a search will

1. *Economic Problem*, op. cit., p. 53.
2. *Ibid.*, p. 56.
3. *Ibid.*, p. 58.

have to be made for distant ones and wealth will be distributed among them. If no relatives, near or distant, are forthcoming, even then a man is not entitled to adopt any heir himself. In that event the whole community will succeed him and so all his accumulated wealth will be deposited in the Public Exchequer. In this manner even if a man may concentrate millions and billions of pounds, it will be distributed after his death in small proportions within two or three generations and every such accumulation will be turned gradually into circulation"[1] in the community.

Thus in a couple of generations the property of the rich would be divided among hundreds and thousands of their heirs and this would increase the propensity of the community to consume. When the Law of Inheritance is working in conjunction with Zakat and Zero rate of interest, it would achieve the desired results (full employment) in a much shorter period.

The legal measures, explained above, are the pillars of the economic system of Islam. Infaq (i.e. private expenditure in the way of God) provides the necessary lubrication and helps in proper functioning of the legal machinery without undue interruptions or friction. In consequence, the inequality of opportunities created by unjust accumulation and unfair distribution of wealth vanishes in no time. The society, which has been split up into the over-nourished and the under-nourished, with superfluous wealth extravagantly squandered on the one hand and abject poverty and insecurity on the other, is welded together through love, fraternity, co-operation engendered by moral teachings of Islam.

The most important and significant part played by Zakat and the Zero rate of interest in this system will be explained in the following pages.

1. *Economic Problem*, op. cit., p. 58.

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Chapter 1

PROBLEM OF INTEREST

(1)

In the previous Chapter, we have outlined the Principles of the Islamic Economy. There, Principles are operative in all spheres of the Economy. In the following Chapters, we intend to deal at length with the problem of the rate of interest.

Let us briefly analyse the various theories of interest. It is paradoxical to note that there is not a single adequate and generally accepted theory of interest which can give a sound explanation of the origin and the cause of interest. There is least agreement among the economists as to the exact origin or even causes of interest as pointed out by the following quotation of Haberler. Haberler writes :

> "The Theory of interest has for a long time been a weak spot in the science of economics, and the explanation and the determination of the interest rate still gives rise to more disagreement amongst economists than any other branch of general economic theory."[1]

Theories of Interest

The early view on the theory of interest stressed ethical, religious and legal elements, all of which centre round the institution of usury.

Until the publication of Keynes "General Theory" the orthodox approach to the theory of interest rate consisted in the analysis of two 'real' elements which were supposed to determine the 'pure' interest. The structure of interest rates

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was then explained with the aid of the uncertainty factor which gives rise to the risk premium as a differential element.

As a rule, all complete orthodox theories, such as those of Boehm Bawerk, Fisher and Hayek, combined together the psychological and the productivity factors. The treatment of uncertainty by earlier writers was vague and only recently this subject has begun to receive proper attention.

It has now been commonly recognised that the 'real' approach has to be regarded as the first approximation to the theory of the rate of interest. 'The real rate of interest'——as determined by productivity and psychological factors and differentiated by uncertainty——is only one of the determining factors of the monetary rate of interest which is met in reality. Monetary factors form the second group of component elements of a full account of the determination of interest rates.

The modern contribution, however, stimulated by the Liquidity Preference Theory consists in the formulation of a competing theory in terms of the supply and demand for Loanable Funds and in the supply and demand for money and the subsequent reconciliation of the Liquidity Preference with the Loanable Funds approach.

Attempts of co-ordination between the 'real' and the 'monetary' approaches in the theory of interest rate and the indication of the most recent methodological developments defined in the 'assets-preference' approach are the new trends in the theory of interest.

But it seems that all the attempts of co-ordination have so far failed. Attempts of E. Lundberg and Hayek failed because of the inherent confusion between the stock and flow concepts. As a result, they shifted to the concepts of the 'loanable-funds' theorists. Attempts of *F. Modigliani,* whose theory in many respects falls in line with the views of J. R. Hicks and A. Hansen, also seems to have failed.

Indeed it may be added that all these approaches to the problem of the rate of interest have helped more to confuse the real issue. It is time to reconsider the whole problem of interest "which deserves rehabilitation and honour" entirely from a different point of view and, if need be, "even by invoking the sanctions of the moral law".

1. Legal Usury Doctrine

The doctrine of legal usury consists of two distinct approaches :

(i) The original, older concept of usury was based on ethics and expressed by legislation. This idea was common to all ancient societies and it still exists in some modern societies. As a result, many ancient civilised nations, including Roman and Greek, prohibited the charging of interest in their territories. Even in the Middle Ages, usury was strictly prohibited by canon laws.

(ii) Another doctrine of usury was represented chiefly by the Medieval Church. Its characteristic feature was the prohibition of interest.

All ancient civilized nations of the ancient world, and the Christian Middle Ages were exceedingly unfavourable to interest. There were explicit instructions in the *Bible* regarding interest, such as "Lend, hoping for nothing again" (Luke). The Christian Church lent its arms and, step by step, it managed to introduce the prohibition into legislation.[1] The Ecclesiastical ban on usury continued until the end of the Middle Ages, as late as the 13th century.

"The hostile expressions of the ancient world, not few in number, consist, in part, of a number of legislative acts forbidding the taking of interest and in part accidental utterance of philosophers such a Plato, Aristotle, the two Catos, Cicero, Seneca and Pantus etc. Greek philosophers regarded money as nothing but a medium of exchange and, therefore, they denied the productivity of money loans. A piece of money cannot beget another piece was the doctrine of Aristotle. The obvious conclusion was that interest is unjust.[2]

1. Boehm Bawerk, *Capital and Interest*, Vol. I, 1959, pp. 10-11.

2. Bawerk quoted earlier.

2. Scholastic Doctrine

Among the views described in the preceding section the scholastic theory of interest provides the best example of a coherent 'institutional' doctrine. It was connected with the philosophy of the ancient Greeks who were a source of both principles and informations for all great scholastic thinkers, such as St. Augustine, St. Thomas Aquinas, Antoninus of Florence and many of their followers. Aristotle is regarded as the originator of the thesis of unproductivity of money, which led to the conclusion that interest was unjust. Plato also thought that no interest should be given nor even the principle of a debt be paid. All these great thinkers were opposed to the institution of interest and strongly condemned it as unjust and against social justice.

Thomas Aquinas was of the opinion that "To take usury for money lent is unjust in itself, because this is to sell what does not exist". Antoninus of Florence declared that "Money is not profitable of itself alone, but it may become profitable through its employment by merchants". A number of scholastic writers developed this line of reasoning.

An Italian writer Mirbean is very rigorous in his condemnation of money interest. "All in all", he says, "money interest ruins society by putting incomes into the hands of people who are neither owners of land, nor producers, nor industrial workers, and these people can be compared only to hornets, who live by plundering the hoards of the bees of society".[1]

3. The "Colourless" Theories

Boehm Bawerk includes all the classical economists, such as Adam Smith and Ricardo among the colourless theorists. A. Smith and Ricardo do not distinguish clearly between interest and gross profit and often confuse interest with gross profit on capital. According to these economists interest is the compensation paid to the lender of capital by the borrower for the profit he makes by using his capital. Thus interest is determined

1. Bawerk, op. cit., p. 34.

by the rate of profit which is independent of the quantity or of the value of capital. And in their opinion "whenever a great deal can be made by the use of money, great deal can be given for the use of it."[1] Further they regarded all capital as stored up labour and attributed all value to labour.

A. Smith looked on the problem of interest as essentially a problem of price and emphasised the necessity of interest on two grounds :[2]

(i) in order to call forth a sufficient supply of capital ;

(ii) because the necessity of advances leads to a never ceasing capital.

A large number of colourless writers among early German economists including Sartorius, Luederand and Kraus, follow A. Smith and copy "his vague hints concerning interest almost literally, in particular his remark that, if there were no interest, the capitalist would have no inducement to employ his capital productively."[3]

A few of the economists, such as Count Soden and Lotz, placed "greater emphasis on those passages in A. Smith which hold that interest is a share in the product of labour accruing to the capitalist."[4]

Reduced to its essence, Ricardo's theory explains the rate of interest by the rate of wages ; the rate of wages is the cause, the rate of interest the effect".[5] He further emphasises "there is a connection between interest and wages, and that the increase of one factor involves the loss or curtailment of the other".[6] In another passage he seems inclined to the view that interest arises out of a special surplus value. In fact, he has presented different propositions without reaching a conclusion."[7]

1. Ricardo, *Principles of Political Economy and Taxation.*
2. Cassel, *Nature and Necessity of Interest*, London, 1903, p. 23.
3. Bawerk, op. cit., p. 54.
4. *Ibid.*, p. 55.
5. *Ibid.*, pp. 61-62.
6. *Ibid.*, p. 64.
7. *Ibid.*, p. 62.

Criticism

While criticising Ricardo's theory of interest, Boehm Bawerk remarks that it "has no validity whatever for those who hold his rent theory to be fundamentally untrue. Further, that portion of the argument which is based on the wage fund theory is open to all the objections that can be raised to that theory". In his opinion even if the correctness of the rent theory and of the wage fund theory is granted, the rate of interest is not explained by his theory[1] "because he has mistaken what are simply accompanying circumstances of the phenomenon for its cause".

Boehm-Bawerk further says that[2] "interest, no less than wages, may be said to stem from independent motives. To have ignored those motives completely is the decisive blunder committed by Ricardo (and others who follow the same line of argument). The peculiar nature of this blunder also explains most naturally the otherwise astonishing phenomenon, that the comprehensive investigations which so distinguished a thinker as Ricardo devoted to the question of the rate of interest were marked by such complete absence of progress toward the solution of the principal question, the causes of that interest".

MacLeod, an English economist, severely criticises such interest theories and "rejects the doctrine that interest is a constituent of the cost of production. He disputes Ricardo's statement that the rate of interest is conditioned by the rate of wages."[3]

Ricardo and his followers do not explain how to relate fixed interest to variable profit which may sometimes be negative. Further, they do not explain the basic question of the productivity of money.

Furtheromore, it is not certain, as Ricardo and others have emphasised, that the sum saved out of a given income necessarily increases when the rate of interest is increased and falls when the rate of interest is decreased. In the past two and a half centuries savings have greatly increased in spite of a steady fall

1. Bawerk. op. cit., p. 62.
2. *Ibid.*, p. 64.
3. *Ibid.*, p. 70.

in the rate of interest. Keynes seems to be fully justified in criticising the Classical theories when he says that interest is not a reward for saving because people can do save without lending at interest, and can receive interest by lending money, not saved by them but inherited. And Keynes further argues that saving is not determined by interest particularly in a society as ours where greater amount of saving comes from Corporations, banks, Co-operative societies etc. and not from individuals. There are a number of factors, such as size of income, desire for security and power and other psychological factors influencing the preferences of the individual as between the present and the future, which together determine the aggregate amount of saving in a community is not likely to be affected very much by changes in the rate of interest.

4. The Abstinence Theory

Senior is considered as the founder of the Abstinence Theory. He called interest as a reward for abstinence on the part of the capitalist. He distinguishes two "primary instruments of production, labour and forces of nature. But these instruments cannot attain complete effectiveness, unless they are supported by a third element. Senior calls this third element "abstinence", by which he means "the conduct of a person who either abstains from unproductive use of what he can command, or designedly prefers the production of remote to that of immediate results."[1] And according to Senior the "Sacrifice" which lies in the renunciation or the postponement of gratification, demands compensation. That compensation is interest.[2]

In the 20th century many economists, inçluding Marshall, MacVane, Carver, Macfarlane and Cairness, have put forward and effective plan in its defence. Cairness used the term postponement;[3] MacVane replaced the expression "abstinence" with "waiting"[4] which was approved by Marshall as equivalent

1. Bawerk, op. cit., pp. 179-180.
2. *Ibid.*, p. 181.
3. *Ibid.*, p. 40.
4. *Ibid.*, p. 41.

to "postponement of enjoyment."[1] Marshall introduced two of his own terms which he called the "prospectiveness" and the "productiveness" of capital as the fundamental causitive factors in the origination of interest.[2] "Prospectiveness" of capital involves "sacrifice of the present for the future" in order to accumulate it while "productiveness" makes it the object of demand.[3]

Criticism

Many economists have ridiculed and condemned this doctrine of Senior. Lasselle made the whole conception of abstinence ridiculous by representing the millionaires of Europe, the Rothschilds etc., as ascetics for the sake of society.[4] To quote him : "Interest is the wage of renunciation ! Felicitous word, priceless word ! Your European millionaires are ascetics".[5]

According to Boehm, "the existence of interest and its rate do not exhibit the slightest degree of co-relation with the existence and the degree of "sacrifice of abstinence."[6] In his opinion Senior's theory of abstinence has two shortcomings : In the first instance, Senior gives too much prominence to the factor of postponement of gratification. It is true, he says, that this factor does exercise a certain amount of influence on the origin of interest but the influence is neither so direct nor so exclusive that we may say that "interest is the wage of abstinence and that's that."[7] In the second place, Senior has presented the doctrine in a way which is vulnerable to attack. Boehm regards it "an error in logic to present the renunciation of gratification, or abstinence in the abstract, as a second and independent sacrifice, apart from the labour that is sacrificed in production."[7]

1. Cassel, op. cit. p. 42.
2. Bawerk, op. cit., p. 380.
3. *Ibid.*, p. 380.
4. Cassel, op. cit., p. 39.
5. Bawerk, op. cit., p. 183.
6. *Ibid.*, p. 185.
7. *Ibid.*, p. 184.

In the opinion of Boehm-Bawerk, Marshall's re-orientation of the expression abstinence does not make much difference. He thinks that the connecting link in Marshall's explanation of the problem of interest "reveals the same flaw as does that of other postponements of the abstinence theory."[1] The term "abstinence" became discredited and ultimately dropped out of use[2] and was replaced by other names, as explained earlier in this section.

Cassel and Henderson have also criticised this theory on the ground that it does not give any satisfactory reason for the existence of interest. Thus the abstinence theory, as put forward by Senior and his associates, has failed to offer any reasonable explanation of the rate of interest.

5. Productivity Theory

The advocates of this theory consider productivity as an inherent property of capital and, therefore, they justify interest as remuneration for this productivity. According to Boehm, the proposition that capital is productive, may signify any of the following :[3]

(*i*) "Capital has the capacity of serving to produce goods ;

(*ii*) Capital has the power of serving to produce more goods than could be produced without it ;

(*iii*) Capital has the power to produce value greater than could be produced without it ; and

(*iv*) Capital has the power to produce value greater than that which it possesses itself."

Boehm has divided Productivity Theories into two groups : (*a*) The Naive Productivity Theories and (*b*) Motivated Productivity Theories.

(*a*) The Naive Productivity Theories

"According to Say "capital renders production services for which the owner must be paid, and that pay-

1. Bawerk, op. cit., pp. 380-382.
2. Cassel, op. cit., p. 39.
3. Bawerk, op. cit., p. 75.

ment is interest."[1] His remarks about 'surplus value', which is produced by capital, may be divided into two groups. "In one group he represents capital as endowed with the power of creating value and the payment for the productive services of capital is the result of the existence of surplus value. In the second group he reverses the casual relation, by representing the payment of the services of capital as the cause of the existence of surplus value."[2]

But Boehm rejects Say's proposals as sharply contradictory and this he says is the natural consequence of his uncertainty about the whole theory of value.[3]

Riedel explains the doctrine of productivity in this way:[4] "Whenever the use of capital results in the creation of material values exceeding the value of the aid which nature and labour have furnished, the result must be termed the product of capital."

In the opinion of Wilhelm Roscher, capital produces 'surplus value' directly by its own peculiar power. But, according to Boehm, this "theory can lay but slight claim to the cardinal theoretical virtues of unity, consistency and profundity."[5]

Criticism of the Naive Productivity Theories

The main points of criticism of this theory may be summarised as follows:

(*i*) Surplus value has been attributed to the productive power of capital without showing any reason for it. There is no proof that capital actually possesses such a power.[6]

(*ii*) The socialist school has criticised these theories as an inadequate and unscientific explanation of interest. Their scientific blunder is that they have taken a mere hypothesis for

1. Bawerk, op. cit., p. 81.
2. *Ibid.*, p. 82.
3. *Ibid.*, p. 83.
4. *Ibid.*, p. 85.
5. *Ibid.*, p. 87.
6. *Ibid.*, pp. 87-88.

a proven fact, i.e. "hypothesis of value creating power in capital." This is because "value is not produced at all, and cannot be produced. We never produce anything but forms, shapes of material, that is today, things, goods. These goods can of course be goods possessing value, but they do not bring value with them ready made, something inherent that results from production. They only acquire value from the wants and satisfaction of the economic world. Value has its source not in the past of goods, but in their future."[1]

(*iii*) Furthermore, physical productivity ascribed to capital is supposed to include a surplus of value, besides replacing the costs of capital expended. It is granted that more goods can actually be produced with its help than without and that the value of such goods is higher "than the smaller amount of goods produced without it. But there is not one single feature in the whole set of circumstances to indicate that this greater amount of goods must be worth more than capital consumed in its production".[2]

(*b*) The Motivated Productivity Theories

The Motivated Theorists are in agreement with the Naive Theorists regarding the productive power of capital as the ultimate source of interest but they show a two-fold advance in the working out of the basic idea. Firstly, they have avoided the term "value creating powers" of capital and, secondly, they have used the "productivity of capital" in the sense of "physical productivity." Besides, they don't consider that excess value, accompanying physical productiveness is self-evident and therefore, they give reasons to support their argument.[3]

The chain of motivated theories begins with Lord Lauderdale, followed by Malthus and American economists, Carey and Pesbine Smith, and German economists, Thunen and Strasburger. Some of the modern economists, such as Francis Malker,

1. Bawerk, op. cit., p. 90.
2. *Ibid.*, p. 93.
3. *Ibid.*, p. 95.

J. B. Clark, Wieser and Karl Adler, are also adherents of a motivated theory of interest.

According to Boehm, both Strasburger and Lauderdale confuse gross interest and capital value on the one hand with net interest on the other. Both are guilty of the same misinterpretation of the true effects of the premises they assumed, and of the same neglect of the true causes of the phenomenon they seek to explain.[1] In his opinion, "the return to the starting point demonstrates the utter futility of the events that lie bewteen. It was hopeless from the outset to attempt to explain interest wholly and entirely on the basis of a productive power of capital. The only thing that productive power can do is to create a large quantity of a product, thereby creating, at most, much value, but never excess value.

Jevons tries to explain the doctrine of interest through the Marginal Productivity Theory of interest. His views may be expressed in these words :[2] "The sole function of capital is to enable the producer to put a certain interval between beginning and end of the production process. In this way the productivity of labour is considerably increased, and therefore, something can be paid for the use of capital. The price of this use is however, not regulated by the total increase of productivity, but that increase which is caused by the last extension of the productive process. In accordance with that view Jevons regards the productivity of the use of capital as a function of the time "t" that the producer can afford to spend on production".

"Now, as the producer has to pay interest for his use of capital, he cannot extend the time production indefinitely. He is bound by the condition that the productivity of the marginal extension never goes below what he has to pay for that extension in the form of interest. Hence he must stop at the point where the increase of the product is just swallowed up by the extra interest he has to pay."

Kunt Wicksell and Von Hayet also emphasise the marginal

1. Bawerk, *op. cit. p. 120.*
2. *Ibid.*, *pp. 52-53.*

productivity theory of interest.[1]

Criticism of Productivity Theories

All the Productivity theories of interest are fundamentally defective because they do not give but only a subordinate role to monetary, psychological and other factors. They have given no consideration to the part played by the changes in the quantity of capital on the rate of interest. The importance of money and credit in relation to the rate of interest has also been completely ignored.

These theories have, in fact, failed to explain the origin and cause of the rate of interest. Even the marginal productivity theory explains merely "the rents paid on capital asset", which are only sums (of money). But we must know the value of the capital asset itself, in order to find out the rate of interest. And the value of capital asset can only be calculated if we know the rate of interest on money loans. Thus the process of calculating the value of capital, known as "capitalisation" is dependent upon the pre-existence of the rate of interest. Therefore any attempt to explain the rate of interest on money loans through the productivity of the borrowed capital should "involve us in a circular reasoning".[2]

Besides, these theories are based upon the presumption of a stationary state with static equilibrium and ignore the dynamic real life, full of complex problems, such as changes in population, tastes, preferences, growth of capital, inventions and other technical improvements, changes in the quantity of money and credit and many other changes.[3] All these multifarious changes are bound to act and react on each other and thereby may collectively influence the value of any capital that may be employed.[4]

Furthermore, "the defect of the productivity theory of interest is identical with that of the use-school concept discussed below. This is because 'the productivity of a concrete capital' is

1. Shaikh Mahmud Ahmad, *Economics of Islam*, p. 34.
2. Anwar Iqbal Qureshi. *Islam and the Theory of Interest*, p. 22.
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only a special instance of the use of a concrete capital ; and the former conception is therefore as insufficient for a complete explanation of interest as the latter".[1]

6. The Use Theories

The use theories of interest are an offshoot of the productivity theories and very closely resemble the basic ideal which wrecked the latter, namely the recognition of an exact causal connection between the value of products and the value of their means of production. The use theories are founded on the principle that the use of capital is a quality of capital independent of its substance. That is to say, the use of capital has an independent nature and independent value. To obtain a return on capital it is not enough to sacrifice the substance of capital alone ; the "use" of capital employed must be sacrificed as well during the period of production. And the exponents of these theories claim that component part of value which goes under the name "excess value" corresponds to that component part of sacrifice which goes under the name "use of capital".[2]

Thus these theories assume that capital is productive, but they make the assumption with no specific emphasis and without suggesting complex implications.[3]

The development of these theories is associated with the names of J. B. Say, Hermann and Karl Menger. The use theory was earlier proposed by Turgot who, like Menger, adopted a definition of the use of capital as an arithmetical quantity. And "it follows immediately from it that the use of capital is a quantity of two dimensions, the measure of it being a certain sum of value into the time of use. Now this is the same measure as that or waiting ; and, consequently, we may infer that waiting and the use of capital denote the same thing. In fact, they signify one and the same productive service : "waiting" is used to express what is done by him who supplies the service,

1. Cassel, op. cit., p. 51.
2. Bawerk, op. cit. pp. 122-123.
3. *Ibid.*, p. 123.

and "use of capital" to express what is obtained by him who buys the service".[1]

In the late 19th century and early 20th century, the concept that interest is a payment for the use of capital "found many friends among the economists, such as Walras, Cassel, Oswalt, Zaleski and Margolin.

Criticism

Boehm rejected the validity of the assumption that there was beside each capital good a "use" thereof which was an independent economic good possessing independent value. He further emphasised that "in the first place, there simply is no such thing as an independent "use of capital", and, consequently, it can not have independent value, nor by its participation give rise to the "phenomenon of excess value". To assume such a use is to create an unwarrantable fiction that contravenes all fact".[2]

"In the second place, even if there existed the kind of use of capital that is postulated by the Use Theorists, it would still not provide a basis for the satisfactory explanation of the phenomenon of interest, as the latter actually manifests itself. Therefore the Use Theories are founded on a hypothesis which is neither consonant with reality nor capaple of attaining the solution which was its purpose".[2]

Besides, what is the meaning of the phrase "use of capital"? It is hard to give an exact definition of "use" and there is no agreement even among the Use theorists themselves as to the nature of "use".[3] Boehm emphasises "that even if we accept the hypothesis that an independent net use of capital exists, the Use theory cannot lead to a satisfactory explanation of interest".[48] According to Boehm, "a tacit verdict as to its inadequacy is implicit in the fact that efforts were continued to seek other explanations".[5]

1. Cassel, op. cit., p. 48.
2. Bawerk, op. cit., p. 141.
3. *Ibid.*, p. 142.
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In fact, these theories, like the other theories explained earlier, failed to give an adequate and complete explanation of the origin and cause of the rate of interest.

7. The Remuneration Theories

A number of theories expounded by the English, the French and the German economists which call interest the remuneration of labour performed by the capitalist are termed as the Remuneration theories by Boehm Bawerk.[1]

(a) The English Group

This group explains interest as the remuneration for the labour which was originally spent to create the capital good itself. The chief exponents of this group are J. Mill and MCulloch.

Even if it is granted that remuneration of capital is the reward for mediate labour (as Mill prefers to call capital), it fails to solve the problem. Why mediate labour is compensated at a higher rate than immediate labour, since "the latter receives the simple labour wage ; while the former receives an annuity which exceeds the labour rate by the amount of interest ?"[2] Mill seems to have no answer.

(b) The French Group

This group explains interest as the remuneration of the labour wich consists in the "saving up" of capital. Chief representative of this group is Courcelle Senevil. According to this group, the 'labour of saving' is entitled to remuneration just as 'labour of muscular exertion'. The latter is remunerated in the form of wages while the former is paid in the form of interest.

The rate of this compensation is determined "by the laws of supply and demand ; it is governed, on the one hand, by the desire and the ability to employ a capital sum re-productivity, and, on the other, by the desire and the ability to accumulate that sum by saving".[3]

1. Bawerk, op. cit. p. 195.
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This theory is a disguised version of Senior's Abstinence theory and is, therefore, open to all those objections which have been raised against the latter. But, in addition, this theory exhibits weakness of its own. There is no doubt that foresight and saving do require some effort but "the mere fact that the performance of labour in a certain set of circumstances is accompanied by the receipt of income is not by any means a justification for maintaining that the income is the wage of that labour. In order to advance such an argument one would have to be able to prove that the income is actually given in return for the labour and only in order to procure that labour".

If the above argument advanced by Courcell is admitted, why then is such a difference in wages ? A difference between various persons who labour for saving and a difference in comparison with the wages received by muscular labour. Quite obviously, a "theory which explains interest as a wage of labour should certainly undertake to go into a rather detailed explanation of such things".[1]

(c) The German Group

Rodbertus and Jogetzow are considered the fore-runners of this group. Their theory of remuneration is based on the same principles as that of the French Group and is, therefore, open to same objections. Boehm says that it can be stated with certainty that there is no co-relation whatever between interest and expenditure of labour by the capitalist. If so, "how can it be rationally possible for that labour to provide the principle which will explain interest ?[2]

The remuneration theory is quite inadequate of supplying any tenable theoretical explanation of interest.

Among the modern economists A. Wagner and Stolzmann have supported this theory. Stolzmann presents his own modified version to which he gives the name of "labour cost theory".[3] According to him, labour and services of capital are the source

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In the opinion of Boehm, this theory is open to all the ojections which have been raised against remuneration theories in general. In addition "the fundamental basis of his whole theory of value, his law of labour cost, is completely untenable".[2]

8. The Exploitation Theory

Socialist and communist writers, such as Karl Marx and his followers, developed the doctrine of A. Smith and D. Ricardo that the source of all value is labour and propounded the exploitation theory of interest. According to the exponents of this theory, "all goods that have value are the product of human labour. The workers, however, do not receive the entire product which they alone have produced. The capitalist exercises the control over the indispensable means of production which the institution of private property guarantees him, and he uses such control to secure for himself a part of the workers' product. The price the capitalist pays them is a fraction of what is produced by them, and the rest of the product falls into the lap of the capitalist at the cost of no exertion to himself. Interest, therefore, consists in a portion of the product of the labour of others acquired by exploiting the situation which places the worker under coercion".[3]

Socialists and Communists, following the logical sequence of the old doctrine of value to the "very ultimate limit of its theoretical and practical implications, arrived finally at the conclusion that interest is exploitation, and so it must go".[4]

1. Bawerk, op. cit., p. 403.
2. *Ibid.*, p. 404.
3. *Ibid.*, p. 241.
4. *Ibid.*, p. 246.

Some of the old economists who supported this theory are Sismondi, Proudhon, Rodbertus, Marx, Lasselle and Guth. According to Sismondi, "political economy has a moral purpose. It is not concerned with wealth as much, but with wealth in relation to man. It has to study economic activity from the point of view of its effect on human welfare". For this purpose Sismondi regards the problems of distribution as more important than any other economic problem or problems. He stresses distribution because his concern is mainly with social justice".[1]

He says that, "since property and labour are separated, revenue is under the control of the capitalist. It depends on the capitalist's demand for labour and this is constantly fluctuating, because it is determined, not by the needs of consumers, but by the need to produce in order to employ capital profitably".[2]

In his opinion, "the rich, who own all these things (raw-material, instruments, machines etc), thus acquire a certain control of the labour of the poor. Without doing any of the work themselves, they take in advance the best part of the fruit of that labour to compensate themselves for the advantages which they put at the disposal of the poor. This "best part" is interest. Thus, by reason of the organisation of society, wealth has achieved the ability to reproduce itself through the labour of others".[3]

As for Production, "one moral idea underlies the whole of his thought ; the idea of justice." And in his opinion, concept of justice can be realised by society by reconciliation of opposing forces.[4] "The abuse of private property" he says, "consists mainly in the ability to extract income without labour. One of the most important ways in which this is done is through the charging of interest on money. *If only every body were able to obtain loans gratuitously no exploitation would take place.* Nor would there be any difficulty in establishing worker's syndicates.

1. Eric Roll, *A History of Economic Thought*, p. 236.
2. *Ibid.*, p. 237-238.
3. Bawerk, op. cit., p. 244-245.
4. E. Roll, op. cit., p. 241.

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In his opinion, "the rich, who own all these things (raw-material, instruments, machines etc), thus acquire a certain control of the labour of the poor. Without doing any of the work themselves, they take in advance the best part of the fruit of that labour to compensate themselves for the advantages which they put at the disposal of the poor. This "best part" is interest. Thus, by reason of the organisation of society, wealth has achieved the ability to reproduce itself through the labour of others".[3]

As for Production, "one moral idea underlies the whole of his thought ; the idea of justice." And in his opinion, concept of justice can be realised by society by reconciliation of opposing forces.[4] "The abuse of private property" he says, "consists mainly in the ability to extract income without labour. One of the most important ways in which this is done is through the charging of interest on money. *If only every body were able to obtain loans gratuitously no exploitation would take place.* Nor would there be any difficulty in establishing worker's syndicates.

1. Eric Roll, *A History of Economic Thought*, p. 236.
2. *Ibid.*, p. 237-238.
3. Bawerk, op. cit., p. 244-245.
4. E. Roll, op. cit., p. 241.

Proudhon regards money as merely a medium of circulation. Following the canonists, he thinks that, like a commodity, it ought to be bought and sold at cost, and not lent at interest. Lending at interest enables the owner of money to sell one and the same thing several times over without losing his property in it".[1]

"The most important part of Proudhon's economic programme becomes *the creation of free credit through the establishment of an "exchange bank"*. The bank would run no risk because it would only be discounting genuine commercial transactions. The important point, however, would be that this service would not cost anything. Interest being abolished, exploitation through property is abolished too. Moreover, since the exchange bank enables every worker or group of workers to get free credit with which to buy the means of production, the division of classes would disappear".[2]

According to Karl Marx, "Lender and borrower regard the same sum of money as capital, but only the borrower the industrial capitalist—makes it function as such. That capital cannot bring in double profit. Profit is only made once, that is, where the capital is in fact used as capital. The sum of money can appear as capital to both parties only if the profit which it makes is shared between them. The share which the money capitalist gets is interest.[3] "This, according to Marx, is the fruit of labour of the borrower, and hence, the capitalist is not justified in taking any share of it".

Rodbertus defines surplus proceeds as "all-income that is received without work, purely on the basis of ownership of property—interest on land and interest on capital goods". Therefore, he says, "all surplus proceeds are a theft of the product of other men's labour".[4]

Among the modern economists Dietzel, Lewis Oppenheimer, Tugan Baranowsky have supported the exploitation theory of interest.

1. E. Roll, op. cit., pp. 243-244.
2. *Ibid.*, p. 244.
3. *Ibid.*, p. 280.
4. Bawerk, op. cit., pp. 252-253.

To sum up socialists theory of interest, "labour, in the present condition of society, does not get its just reward; the working man is wrongly deprived of a part of "the whole produce of his labour". On this ground the socialists construct a new theory of value according to which the labourer would get "the whole produce of his labour".[1]

Criticism

According to Boehm, it is completely erroneous to say that all goods, economically considered, are only the products of labour. What about the share of nature or natural factors? While criticising Rodbertus, he argues that even if his premises were correct, his conclusion from it would not be. "Even if labour were the only original force with which man carries on his economic activity, one still cannot see why man should not have grounds for conducting his economy through the instrumentality of additional forces besides the "original forces"? The simple fact is that Rodbertus is too narrowly limited in his conception of the nature and the causative forces of human economy."[2]

In his opinion, "the position taken by Rodbertus then becomes more untenable than ever, when he adds the further statement that goods are even to be regarded solely as products of manual labour. This statement, in addition to other things, excludes from consideration as economically productive activity even the indirect intellectual labour of the supervision of production labour. And it also leads to a number of other internal inconsistencies and faulty conclusions".[3]

Besides, their argument that the worker is entitled to receive the entire value of his product is wholly un-justified, illogical and unreal. Too much emphasis on the contribution of labour in the process of production by the exponents of this group is wholly untrue and ridiculous. Proudhon, Sismondi and others,

1. Cassel, op. cit., p. 71.
2. Bawerk, op. cit., p. 262.
3. *Ibid.*, p. 262.

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on the other hand, are quite right in their condemnation of the institution of interest as unjust and contrary to social justice.

9. The Eclectics (combination of Productivity and Abstinence) theories

The eclectics present a combination of all the various theories of interest—the most frequent combination is Productivity theory and Abstinence theory. This view is presented by Rossi, L. Cossa, Molivari, Leroy-Beaulieu, Roscher, Schuz, Maxwirth and Jevons".[1]

A second group presents the remuneration theory in one or another form of combination. This line of presentation is taken up by economists, such as Road, Gerstner and Joseph Garvier".[2]

Then there is a third group of eclectics who combine elements from some theories hostile to interest with elements of other theories more or less favourably disposed towards it. This line of thought is supported by T. G. Hoffmann, J.S. Mill and Schaffle.[3]

This line of thought seems to reveal a symptom of dissatisfaction with the doctrine of interest as presented and discussed by the economists of the past and the present. And, as no single theory on the subject is in itself considered satisfactory, people have tried to find a combination of elements from several theories in order to find a satisfactory solution of the problem.[4]

Among the modern eclectic theorists are Loria, Maurice Block, Charles Gide, Nicholson, Valentic and Dietzel.

Criticism of Interest Theories

All the theories of interest, so far discussed, have failed to answer the questions ; why interest is paid ? What determines the rate of interest ? In the opinion of Cassel, this is because,[5] "many of the writers to whom we owe valuable contributions to

1. Bawerk, op. cit., p. 323.
2. *Ibid.*, p. 329.
3. *Ibid.*, p. 331.
4. *Ibid.*, p. 336.
5. Cassel, op. cit., p. 56.

these investigations inclined to regard as the whole theory that which was in fact only the explanation of a special point in it. Thus although much important work was done, scarcely any one had understood how to make the full use of it, i.e. to give every particular truth its organic place in a systematic theory of interest".

Boehm has very successfully shown how interest theories have failed to give a definite solution of the problem. He is, in fact, able to dispose of the majority of his predecessors.[1] Many of those writers, he says, are inconsistent and often contradictory in their statements.[1] Say is full of contradictions because he thinks that both "the use of capital" and "the scarcity of the services of the saver" are equally determinants of interest.[2] In short, Boehm positively rejects all previous solutions of the problem of interest ; firstly, because they are inconsistent and contradictory, and secondly, because they do not give a systematic and complete theory of interest.[3]

1. Cassel. op. cit. p. 57.
2. *Ibid.*, p. 57.
3. *Ibid.*, p. 61.

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3. *Ibid.*, p. 61.

Chapter 2

PROBLEM OF INTEREST

(2)

10. Modern Fructification Theory

Henry George is the founder of this school of thought. After describing that some forms of wealth, such as bees, range of sheep etc. have productive power, he goes on to say that "now what gives the increase in these cases is something which, though it generally requires labour to utilise it, is yet distinct and separable from labour—the active power of nature ; the principle of growth, or reproduction, which everywhere characterizes all the forms of that mysterious thing or condition which we call life. And it seems to me that it is this which is the cause of interest, or the increase of capital over and above that due to labour".[1]

This[2] theory bears some resemblance in its basic concepts to Turgot's fructification theory of interest. He justified interest on capital when invested in an industrial, agricultural or commercial enterprise, on the ground that the owner of capital can make it yield a permanent yearly income by buying land with it. And he will not be inclined to invest his capital in other enterprises unless he can expect just as large a net return as he could obtain through the purchase of land.

Criticism

Boehm objects to the division of capital into naturally fruitful type and barren type which, he thinks, is impossible to

1. Bawerk, op. cit., p. 337.
2. *Ibid.*, p. 41.

support. This introduces the same old error of the physiocrats who regarded agriculture as the only productive process of production. Besides, George has failed to explain "the original phenomenon of interest by which he claims to explain all subsequent instances of it. He says that all classes of goods must bear interest because they can be exchanged for seed-corn, cattle and these bear interest. But why do those bear interest ?[1] He failed to give any reasonable explanation.

11. Modified Abstinence Theory

The chief exponent of this theory is Schellwien. His views are very similar to Marx's socialist theory as far as labour time is regarded as the only yardstick to measure value of goods. According to him, "it is not only the consumability or usefulness of a good, but also the actual consumption of it which exercises determining influence on its value. The value at which all goods aim is realised only upon consumption".[2]

"This", he says, "takes place in two kinds of cases. The first of these occurs where a temporary non-consumption of goods is necessary to enable them to enter into consumption at all. Thus, fruit must be allowed a certain period of time for ripening. In so far as such a time interval is necessary between the completion of a product and its consumption, that interval necessarily brings about an enhancement in value". Therefore, he argues that "any necessary period of non-consumption is just as much a part of the socially requisite production time which determines value, as is the actual labour time".[3]

And according to him, "the second kind of case involves those instances in which the production of an article requires that other commodities be not consumed. That applies in any case in which capital is required for production. And since the capital that is being used in production is, to put it simply, withheld from consumption, the commodity must guarantee compensation for such non-consumption, and necessitate a

1. Bawerk, op. cit., p. 339.
2. *Ibid.*, p. 342.
3. *Ibid.*, p. 342.

corresponding increase in the value of the commodity".[1]

Criticism

Many economists, including Boehm, regard this two-fold interpretation of consumption of capital as erroneous, fallacious and ridiculous. They argue that Schellwien takes both positions simultaneously ; he regards the capital as consumed for which the buyer must pay its full value and the next moment he regards the same capital as "withheld from consumption" so that the commodity must also provide compensation for this non-consumption".[2]

12. The Austrian Theory (The Agio or Time-Preference Theory)

According to this theory, interest arises "from a difference in value between present and future goods". This idea was hinted by men like Petty, Galiani, Turgot and Jevons but was expressed explicitly by Launhardt and Emil Sax. Among American economists J. B. Clark, I. Fisher, F. Fetter, N. Palten and S. M. MacVane support this theory. There are many others among English, American, Italian, German, Scandinavian and French economists who can be classified with above theorists.[3]

The chief exponent of this theory is in fact Boehm Bawerk. The central formula by which Boehm claims to give an explanation of the phenomenon of interest is the "undervaluation of future goods in relation to the present".[4] "Present goods are", he says, "as a rule, worth more than future goods of like kind and number". In other words "interest is an agio obtained by present goods in exchange for future ones".[5]

After explaining the cause of interest, which according to him, is the superiority of the present goods over the future goods, he tries to give his reasons why people prefer present goods to future goods. Then he explains the important factors

1. Bawerk, op. cit., 338.
2. *Ibid.*, pp. 343-344.
3. *Ibid.*, pp. 357-360.
4. Cassel, op. cit., p. 61.
5. *Ibid.*, p. 61.

which affect the rate of interest and re-affirms the importance of the capitalistic process of production. Thereafter his conclusion regarding the rate of interest is that it is determined by the marginal productivity of capital in relation to the element of time in production. Thus, in fact, he arrives at the same conclusion as the supporters of the Marginal Productivity theory of interest with the only difference that he emphasises the significance of the element of time in production. According to him, the rate of interest is determined by the marginal productivity of capital which diminishes as the period of production is prolonged.

Boehm's theory of interest has been further expanded and elucidated by K. Wicksell. His important contribution to theory of interest lies in emphasis on the relationship between the rate of interest and price level and the influence of monetary factors in determining the rate of interest.

Among the followers of Boehm Bawerk, K. Wicksell and V. Hayek stress the importance of the productivity of capital, while Fetter and Fisher support the time preference theory. Boulding has tried towards "Dynamisation" of the time-preference approach but has not been very successful. His views are open to criticism on the same grounds as the general structure of Marginal Utility Theory. Besides, no psychological factor of some kind stands behind the actions of lenders and borrowers.

Criticism

In the opinion of Cassel, "this formula of undervaluation of future goods in relation to present" is, however, ambiguous and has, in fact, two different meanings even with Boehm himself. The same thought was formulated in very much the same words by Bastiat and Even Manger. It seems, therefore, that Boehm has not added much to the analysis of the real conditions of waiting, or to our knowledge of the effects of variations in the rate of interest upon the quantity of waiting offered".[1]

Boehm's "analysis of the reasons for the undervaluation of future goods is also very insufficient". He gives three such

1. Cassel, op. cit., p. 61.

reasons but fails to show how they work together. "There is no sharp line of division between the forces which act on the supply side and those which act on the demand side of the capital market. The lack of a clear grasp of the mechanism of this market is most conspicuous when Boehm goes on to speak of the grounds regulating, quantitatively, the rate of interest. Particularly incomplete is the analysis of the factors working on the demand side".[1]

Furthermore, the psychological subjective foundations on which, Boehm tries to build his Agio theory of interest, are completely untrue and unrealistic. In fact a large number of people save for future without having any consideration whatsoever, for the rate of interest, merely because they consider many of their future needs more important than the present ones. Many people save for future mishaps, accidents, rainy days, old age ; many are likely to save and actually do save, whenever they have the capacity to do so, for education and training of their children and even for holidays ; some may save to satisfy their desire for personal prestige and social power. And all these savings are done without any regard for interest or premium on savings.

And it is further proved by the day-to-day experience of millions of people all over the world, who have barely enough to live on, that no rate of interest, however high, can ever persuade them to starve by saving. Besides, this formula is not applicable to corporations, banks, co-operative societies, which supply the bulk of savings in modern industrial countries and which save for their own security and financial stability and not because of interest.[2]

General Criticism of Interest Theories

A critical study of the historical development of the phenomenon of interest has shown that interest is paid to an independent factor of production, which may be called either waiting or postponement or abstinence or use etc. But all these theories

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have failed to answer or to prove as to why interest is paid or should be paid to this factor. Some point to the necessity of waiting; others to the necessity of abstinence of postponement ; but none of these explanations answer the question. Neither mere necessity of waiting or postponement or abstinence nor mere use or productivity of capital is enough to prove that interest is a necessary payment for the employment of capital in production. Besides, these theories have failed to answer how a variable factor can possibly determine a fixed factor like the rate of interest ? How could such a theory be valid or tenable ?

Cassel brings in scarcity as a very strong and valid argument for the payment of interest for the services of capital. It is a price, he says, which must necessarily be paid to that factor of production, called capital, because of its scarcity. And he argues that "the purpose of the price is to check demand and stimulate supply, and therefore the price must be brought up to the level where it causes demand and supply to meet. Then in order to prove that the factor capital is almost always scarce, he takes the trouble of analysing the various factors affecting the demand for waiting and the supply of waiting".

But the question is still unanswered. Why should interest be paid ? It is not a valid argument to say that interest should be paid to capital for its scarcity. It does not explain why this payment should be made to capital and even if it does, the meaning of scarcity is not very clear. What is scarcity ? When will capital be considered scarce and when not ? What factors should be taken into consideration to determine scarcity of capital ?

And further, "the purpose of the price is to check demand and stimulate supply", which is very ambiguous. Cassel has still to prove that rate of interest checks demand for capital and stimulates supply of capital. Many of his assumptions regarding the causes affecting the demand for and the supply of waiting are entirely untrue, unrealistic and against the past experience of 2½ centuries.

Thus it seems obvious that Cassel's theory does not rest on firm theoretical foundations. Besides, it applies only to capital owned by individuals and, further, application is limited to social conditions as imagined by Cassel.

In the opinion of Harrod, the so-called "orthodox" theories fail to consider in realistic terms the "*Modus operandi*" of the money and capital market and therefore they are not able to explain the process of fluctuation in the level of interest rates but give only a relatively insignificant account of the forces acting in the long run stationary solution and, perhaps, provide an explanation of the nature, but not of the actual level of the rate of interest".[1]

13. Modern Theories

Early economists, such as Cantillon, Hume, as well as numerous modern economists, such as Wicksell, Hayek, Schumpeter, Keynes, Hicks et all have attempted to explain the phenomenon of interest with reference to the quantity of money in circulation and the demand for money. Some of them have tried to find the solution to the problem as to how interest is determined by *(i)* Indirect Monetary approach. This group of theorists hope to find the answer to the problem of interest by an analysis of the changes in the quantity of money, velocity of its circulation or in the demand for money. Others have preferred the (*ii*) Direct Monetary approach method and have tried to explain the rate of interest as a purely monetary problem. Keynes is the modern representative of the second line of approach.

This difference between the approaches of monetary theorists has produced two rival theories. One is the Loanable Funds theory which is supported by B. Ohlin, Robertson, Hicks and many other economists ; while the other is the Liquidity Preference theory which is supported by Keynes and his followers.

The main difference between the two approaches to the problem of interest is that the supporters of the former theory hold the view that the rate of interest is determined by the supply of and demand for loanable funds ; while the supporters of the latter are of the opinion that the rate of interest is determined by the supply of and demand for money itself.

1. P. E. Harrod, *Towards Dynamic Economics*, Chapters 2 and 3.

(i) The Loanable Fund Theory

The Loanable Fund theory of interest is based on the thorough analysis of the two concepts of saving and investment.

In the opinion of the supporters of this theory, the rate of interest is merely the price of credit and is, therefore, determined by the supply of and demand for credit. In the words of Lerner, the Loanable Fund theory can be stated as follows: "The rate of interest is the price that equates the supply of credit, or saving plus net increases in the amount of money in a period to the demand for credit, or investment plus the net hoarding in the period".[1]

In simple words, the rate of interest, according to this theory, is determined by the supply of and demand for loanable funds. If the demand for loanable funds is in excess of supply, other things being equal, the rate of interest will rise and if it is less than supply, the rate of interest will fall. The advocates of this theory believe that "the dynamic movement of interest is determined by the excess demand which exists in the loan (money) market".[2]

The demand and supply of loanable funds are influenced by investment opportunities and total savings and bank credit respectively. If investment opportunities resulting from new inventions tend to increase demand for loanable funds more rapidly than the available total savings and credit facilities during any period of time, the rate of interest will rise and vice versa.

The idea of studying the rate of interest with reference to the market on which it is being established is not a new one. Such a method of approach was clearly established about two centuries ago by R. Cantillon. According to him, the rate of interest may be compared to prices and therefore its level is dependent upon the quantitative relation of borrowers and lenders.[3] A considerable number of contemporary economists

1. A. P. Lerner, Alternative Formulations to the Theory of Interest, *Economic Journal*, 1938.
2. O. Patinkin, *Money, Interest and Prices*, p. 265.
3. *Ibid.*, p. 264.

seem to accept this methodological point of view and there are only small terminological differences between them. For example, B. Ohlin speaks about the demand for and the supply of credit;[1] G. Haberler prefers the concept of "investible funds";[2] D. H. Robertson uses the term "loanable funds."[3] Practically all these concepts are used to convey the same meaning and may therefore be reduced to the common basis of monetary loans.

(ii) Liquidity Preference Theory

The importance of liquidity preference in determining the rate of interest is greatly emphasised by Keynes. He says that shifts in liquidity preference can have very significant effect on the rate of interest. While answering the question as to what determined the rate of interest, he pointed out that psychological Time-Preferences of an individual required two distinct forms of decisions:

(i) The first, concerning the propensity to consume, determines for each individual the proportion of his income that he will consume and that he will save for furture consumption;

(ii) Having made this decision, he has also to decide in what form he will keep his savings. Whether to keep them in the form of money i.e., liquid assets or in the form of securities etc. i.e., earning assets? According to Keynes it is the second decision which is important in the theory of interest and not the first one.

Keynes believes "that the mistake in the accepted theories of the rate of interest lies in their attempting to determine the rate of interest from the first of these two constituents of psychological time-preference to the neglect of the second; and it is this neglect which we must endeavour to repair".[4]

Thus the rate of interest will not be a reward merely for waiting or saving as such because a man will not earn anything if he hoards his savings in the form of cash which is just as

1. *Economic Journal*, 1937, p. 221.
2. *Prosperity and Depression*, pp. 201-209 and 255.
3. *Essays in Monetary Theory*, p. 428.
4. General Theory, op. cit., p. 166.

much saving as before. The rate of interest can, therefore, be defined as "the reward for parting with liquidity for a specified time".[1]

Keynes holds that "the rate of interest, at any time, being the reward for parting with liquidity, is a measure of the unwillingness of those who possess money to part with their liquid control over it. The rate of interest is not the "price" which brings into equilibrium the demand for resources to invest with the readiness to abstain from present consumption (as held by classical and numerous other economists of the past and the present). It is the "price" which equilibrates the desire to hold wealth in the form of cash with the available quantity of cash; which implies that if the rate of interest were lower, i.e. if the reward for parting with cash were diminished, the aggregate amount of cash which the public would wish, would exceed the available supply, and that if the rate of interest were raised, there would be a surplus of cash which no one would be willing to hold. If this explanation is correct, the quantity of money is the other factor, which, in conjunction with liquidity preference determines the actual rate of interest in given circumstances".[2]

Thus the rate of interest depends upon two things :

(i) The state of liquidity preference (demand aspect); and

(ii) The quantity of money (supply aspect).

There are in fact several reasons why people will like to keep their wealth in cash. These may be classified according to their motive as :

(a) The Transaction-motive, i.e., money required for personal and business exchange ;

(b) The precautionary-motive, i.e., money required for unforeseen contingencies and future security ; and

(c) The speculative-motive, i.e., betting in the security market.

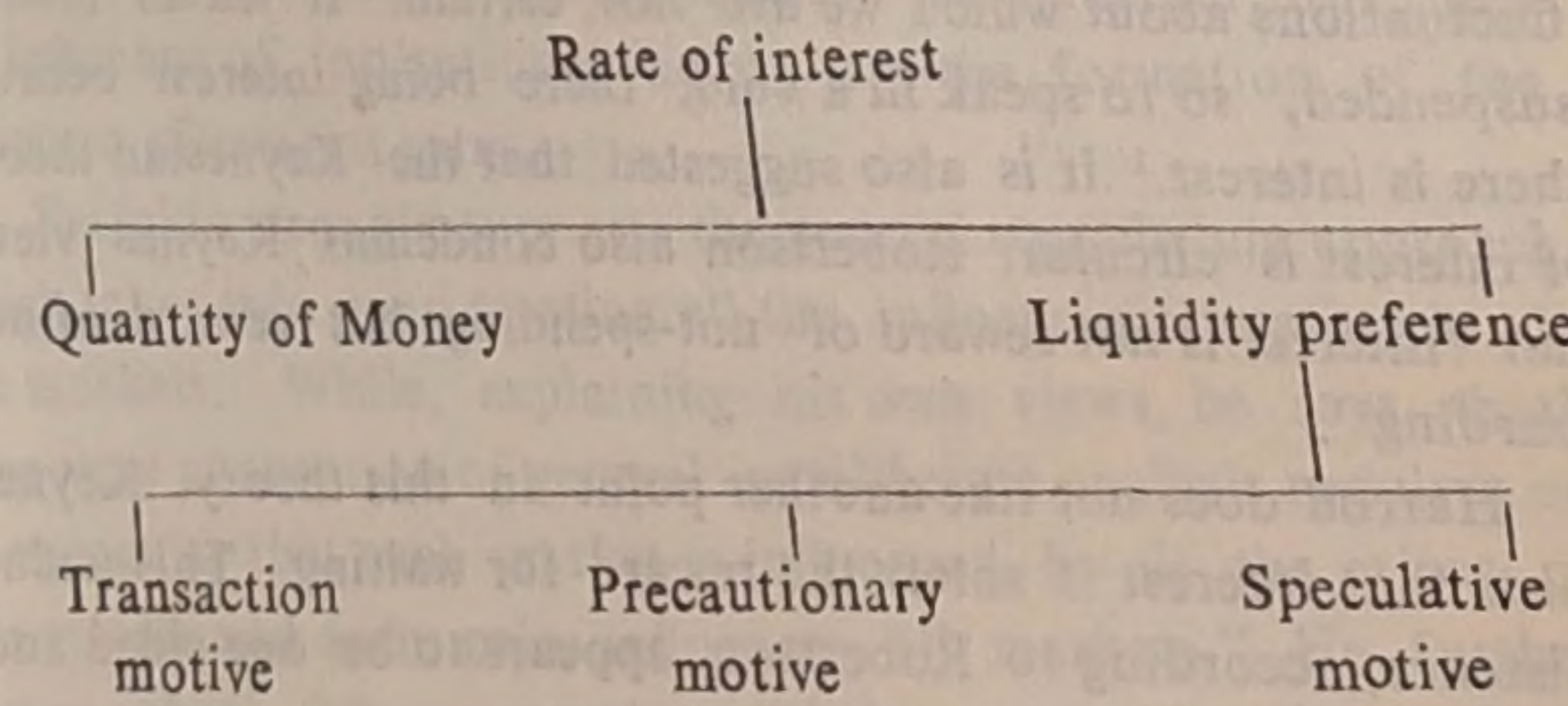
The demand for cash for the first two motives is almost

1. General Theory, op. cit., p. 167.
2. *Ibid.*, pp. 167-168.

stable and mainly it is the third motive, i.e., the speculative motive, which, owing to the uncertainty of the future, is likely to require a larger quantity of cash. Therefore, in general, as the liquidity preference for the speculative motive weakens, the rate of interest falls and vice versa.

It may, however, be pointed out that liquidity preferenee changes in accordance with the changes in the attitude of the people towards the economic and political future. Thus it seems that the rate of interest is dependent upon such factors which are highly psychological in nature. Further, the so-called psychological factors are themselves conditioned by more objective events in the economic and political arena : and may even be influenced by the conventional factors.

Briefly, interest rate is a price which fluctuates according to the supply and demand for money. The supply is fixed by the banking system and the demand is determined by the preference for holding cash. As long as the supply remains fixed, the price or rate (of interest), varies with the demand for money.[1]



In recent times several attempts have been made in order to reconcile the liquidity preference and the loanable funds theory but not with much success. Lerner is one of those who made such an attempt to bring reconciliation between the two groups of monetary theorists holding different views. W. Fellner, H. M. Somers and C. Kennedy also made unsuccessful attempts for a co-ordination between the two groups.

1. D. Dillard, *Economics of Keynes.*

(iii) Stocks and Flows Theory

It is, in fact, an attempt of co-ordination between "real" and "monetary" approaches in the theory of rate of interest. It is claimed that both, real and monetary factors, have to be taken into account in a complete theory of the rate of interest.

Scitovszky is the chief exponent of this group. Swedish economists E. Lundberg and Hayek also hold similar views about the co-ordination of the "real" and "monetary" approaches to the problem of interest.

These attempts have not been very successful in achieving their objective. In addition to the confusion between stocks and flows, they suffer from the inadequacy of the partial equilibrium analysis. F. Modigliani's general equilibrium method of co-ordination of the "real" and "monetary" and "institutional" approaches is better but defective like others.

Criticism of Liquidity Preference Theory

According to Robertson, interest in liquidity preference theory is reduced to nothing more than a risk-premium against fluctuations about which we are not certain. It leaves interest suspended, so to speak in a void, there being interest because there is interest.[1] It is also suggested that the Keynesian theory of interest is circular. Robertson also condemns Keynes views that "interest is not reward of not-spending but reward of not hoarding".

Harrod does not like another point in this theory. Keynes insists that interest is solely the reward for waiting. This undue insistence, according to Robertson, appears to be one-sided and not very successful for Keynes case.

Further criticism of the Keynesian approach results from the conclusion that a more satisfactory combination of the factors determining the structure of interest rates can be obtained by assets-preference approach.

(iv) Assets-Preference Approach

In recent times many economists have suggested that "real"

1. *Essays in Monetary Theory*, p. 25.

and "monetary" factors must be fully taken into account while presenting a satisfactory theory of interest rate. At the same time institutional factors should also be taken into consideration.

Assets-preference approach has thus developed as a sort of "second approximation" after the "first approximation" provided by liquidity preference theory.

B. Higgin's general equilibrium solution, which shows how interest rate depends on the general system of assets-preferences, comprises four kinds of assets. *(a)* cash ; *(b)* bonds ; *(c)* stocks; and *(d)* houses.

Now the problem to be solved is : how much of the individual's wealth will be converted into holdings of each particular asset ? Boulding utilises the same tools of analysis to his preferred-assets-ration theory of interest rate. Then Mrs. J. Robinson makes use of Boulding's analysis and presents her own model in which she demonstrates properly the role of all factors determining the rate of interest, i.e., time-preference, productivity, uncertainty and monetary factors. She further illustrates the influence of institutional factors on the formation of the structure of interest rates.

Patinkin strongly supports the general equilibrium approach which takes into consideration all the influences operating in all the markets. While, explaining his own views, he says that[1] "the very conception of general equilibrium analysis requires us to recognise that each market is influenced by all the prices of the system and each price influences all markets." He further argues that[2] "the general-equilibrium considerations force most contemporary theories to recognise that interest exerts influence in all markets and that, in particular, it operates simultaneously on the "three-fold margin" of time-preference (i.e., consumption decisions), marginal-productivity of capital (investment decisions), and liquidity preference (decisions as to the relative sizes of bond and money holdings)".

1. *Money, Interest & Prices*, p. 2665.
2. *Ibid.*, pp. 266-267.

Continuing his argument in support of his general equilibrium approach, he remarks that[1] "more generally, our analysis of this dichotomy has shown us that the equilibrium values of relative prices, the rate of interest and the absolute price level are simultaneously determined by all the markets of the economy (i.e., the money market, the bond market and the commodity market) ; and that it is generally impossible to break off a subset of markets which can by itself—i.e., by a self-contained tantonment—determine a subset of variables. And the rate of interest is no exception".

Patinkin has very ably demonstrated the inter-relation between the three markets (i.e., the money market, the bond market and the commodity market) and the way changes in the price of one good affects the amounts demanded of all other goods in other markets through the pressure of excess demand or excess supply.

Criticism of Monetary Theories

The monetary theories, like marginal productivity theories, have made no attempt to answer the question ; why should interest be paid ? Or why interest is paid ? They have simply ignored this question and have sought refuge in the theory of value. They say, like all other things, the price of capital is determined by the demand for and supply of money.

But it seems that they have forgotten the basic difference between the two problems ; the theory of value is a problem of exchange, while theory of interest is a problem of distribution. Both loanable funds and liquidity preference theories are basically supply and demand theories of interest and explain it with reference to supply of and demand for loanable funds and money respectively. But they do not give any justification for the phenomenon of interest. Even if capital has a right to proper compensation as a reward for its contribution to the creation of wealth, "it can only draw its share from the increase of national wealth only to the extent of its contribution to it.

1. *Money, Interest & Prices*, p. 268.

It cannot be allowed to run away with its pound of flesh, determined in advance, and unrelated to the actualities of production."[1]

According to Boehm Bawerk, the study of all these theories "reveals the development of three essentially divergent basic conceptions of the interest problem".[2] One group, the representatives of the productivity theory, treats the interest problem as a problem of production. The socialist-exponemts of the exploitation theories treat the interest problem as purely a problem of distribution : while the third group, the supporters of the monetary theories, seeks in the theory of interest, the problem of value.[3]

There is no doubt that all these theorists, having been confused by the very magnanimity and pervasiveness of the phenomenon of interest, have avoided the main issue as to why interest should be paid ? They have, indeed, spent all their energies in solving the problem either of waiting or abstinence or productivity or "labour value" or "the determination of value" and have not said anything about the origin or the justification of the institution of interest.

These theories,[4] in fact, "do not take note of the fact that the fixity of the rate of interest weighs down the elasticity of the processes of production. It retards their innate mobility and stultifies their growth. It is only the Islamic theory of capital profit that can meet all these objections.

It states that capital will share the value produced by it, to be determined as a percentage of the profits earned, rather than a percentage of the capital itself. The percentage of profits is a variable sum, and therefore, does not impose any restraint on production. Unlike interest, it is responsive to the dynamic and mobile nature of production. All variable determinant of value, named and unnamed, including population, currency, tastes, habits, investments, inventions, savings, standard of

1. Ahmad, op. cit., p. 35.
2. Bawerk, op. cit., p. 348.
3. *Ibid.*, pp. 349-350.
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2. Bawerk, op. cit., p. 348.
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living, and a host of others, are included by its nature in Islamic theory of capital profits, while all the Western theories of interest leave them out as we have seen above (except the loanable funds theory which takes a note of changes in currency or assets-preference theory studies the changes in all the three markets)".

"But the Islamic theory takes a note of all variables by making the reward of capital variable, according to what achievement is made by capital. Insistence on fixed interest has confined and contradicted capitalism".

Some of the ways in which this has been done are explained in the following pages.

Chapter 3

MUSLIM SCHOLARS ON INTEREST

'Abul A'la Maududi and Theories of Interest

Maulana Abul A'la Maududi has discussed the positive and the negative aspects of the institution of interest at great length and has pointed out its fundamental evils. An attempt has been made to summarise his main arguments :[1]

A. Negative Aspect of Interest

The first thing we must decide is : whether interest is a reasonable payment ? Is the creditor justified in claiming interest on his loan ? And does justice demand that the debtor must pay to the creditor something over and above the capital loan ? The answer to these questions will have solved half the problem. If it can be shown that interest is approved neither by reason nor by justice, then it can be argued why such an unreasonable institution is kept in society ?

There has been great difference of opinion even among the supporters of the doctrine of interest as to what is interest paid for ? Some say interest is price, but price of what ? What substantial thing is paid by the creditor for which he claims a monetary reward month by month or year by year ? The advocates of the institution of interest find it hard to agree on any one thing.

I. Theory that Creditor Runs a Risk

Advocates of this theory argue that the creditor runs a risk

1. Maulana Abul A'la Maududi, *Interest*, Part I and II.

in lending his capital. He withholds his own wants to satisfy the wants of another person. He lends capital which he would have invested in some profitable enterprise. If the debtor utilises the capital in the satisfaction of his personal needs, he must pay rent for the hire of capital just as he pays for the hire of a house or furniture or transport. The rent will be compensation for the risk undertaken by the creditor in advancing a loan to the debtor as well as a reward for his capital. And if the debtor invests capital in some profitable enterprise, then the creditor is more than justified in claiming a share of the profits.

Let us analyse this argument of "risk". It is true that the creditor runs a risk and sacrifices something when he advances his capital to the debtor ; but this, in no way, gives him a right to charge a price of 5% or 10% per annum for his risk or sacrifice. The creditor, has a good reason to mortgage any of the articles of the debtor or ask for security or for a guarantor for the risk involved ; or if he is not willing to do any of these things, he may not take this risk at all and refuse to advance a loan.

But risk in itself is neither a commercial good which may have a price, nor a house or furniture or transport which may have rent. As for sacrifice, it can be considered as such, so long as it is not regarded as business because it can't be both sacrifice and business. If a man makes a moral sacrifice, he must be satisfied with its moral gains ; and if he talks of reward, he must not then talk of sacrifice but do straightforward business. And if he demands an extra reward over and above the loan capital per annum or per mensem, he must give reasons for doing so and explain why is he entitled to it?

Let us examine the two aspects of interest—a reward for abstaining or a hire charge. It is a reward for abstaining? In fact, the creditor lends only that amount which is in excess of his needs and which he is not using himself. As such, it cannot be a reward for abstaining because he has not abstained from anything for which he can claim a reward.

Is it a charge (rent) for hire? Rent is charged only for those things, such as a house, furniture, transport etc., which

wear out, break and lose some of their value during their use. Rent is a reasonable charge for the wear and tear and the maintenance of these things. But commodities, like foodstuff, or gold and silver or money, cannot be considered under this category and, therefore, rent for them is meaningless.

The most a creditor can say is that he is providing an opportunity to the debtor to make profit with his capital and so he should be given a share out of the profit. But in consumption loans this argument does not hold because the debtors are usually poor people who take loans to tide over their difficult times and there is no profit to share.

In productive loans, there is probability of both profit and loss. If the debtor is running his business on loss, how and on what reasonable grounds is the creditor justified in claiming a fixed monthly or annual income from the former ? And if the profit is equal to or less than the amount of monthly or yearly interest, then how is the creditor justified in claiming his share for doing nothing ; whereas the debtor who has worked so hard, spent his time, labour, working ability and personal capital and then, after spending all this, he gets nothing.

Even if the profit of the debtor is greater than the amount of interest, it cannot be justified either by reason or by a sense of justice or by principles of trade and economics that the trader, the industrialist, the farmer and other factors of production, who spend their time, labour, ability and other powers of body and soul, to manufacture and provide the needs of society, should have profits which are neither certain nor fixed, but the capitalist should have certain and fixed interests. All others have risk of loss but he has guarantee of definite interest. The rate of profit of all other agents rises and falls with the change in prices but the interest of the capitalist is pre-determined and is paid at the same fixed rate monthly and yearly.

But if a creditor wants that his capital must be invested in some profitable enterprise so that it may earn something, the only reasonable and practical course for him is to enter into partnership with some businessman instead of lending capital on interest.

II. Theory that Debtor Makes Profit

The advocates of this school of thought argue that by "waiting" or by "abstaining" for a period of time and not consuming his own capital for the satisfaction of his personal wants, the creditor gives "time" to the debtor along with his capital to make some profits. This "time" has its own "price" which increases with the increase in the period of time. If the debtor is not given any time to make the profitable use of the loan capital, he will not be able to make any profit and his entire business may even be ruined for lack of capital. This time, during which the debtor invests the loan capital, has certainly a "price" for him and he is profitably utilising it. There is no reason why the creditor should not share in the profits of the debtor. Furthermore, they argue that possibilities of profit rise and fall with the increase and decrease in time and there is no reason why the creditor should not charge the price (of time) according to the length of time.

But again the question arises how and from what source the creditor has obtained this information that the debtor will definitely make a profit and not loss by investing the loan capital? How does he know that the debtor will definitely make a profit of a certain magnitude that he has fixed his own share accordingly? And how has he calculated that the debtor will certainly make so much profit during the time he is utilising the loan capital and will, therefore, be able to pay a certain fixed monthly or annual price for it?

The supporters of this theory of interest have not been able to give any reasonable answers to these questions.

III. Theory of Productivity of Capital

One school emphasises the "productivity of capital" as its inherent quality which entitles the creditor to claim a reward (in the form of interest) from the debtor for its use. There are many economists who have emphasised this aspect of the function of capital in production. And in accordance with this view, capital is called "productive". It obviously means that "there

is a market for the productive services of machines (capital) and of other concrete forms of capital as well as for the concrete forms of capital themselves". This view that capital is productive may be taken to mean either that capital has the power to produce more goods than can be produced without it, or that it has the power to produce greater value than can be produced without it, or that it has the power to produce value greater than that which it possesses itself. And interest is a reward for the productive services rendered by capital to the debtor in the process of production.

But the very claim that productivity is the inherent quality of capital is fallacious because capital becomes productive only when it is employed in some profitable business by some one. If it is used for consumption purposes, it possesses no such quality.

Even capital employed in profitable enterprises does not necessarily produce more value for which it can be claimed that productiveness is its inherent quality. It is often experienced, specially in slumps, that employment of more capital not only diminishes profits but actually turns profits into losses.

Even if capital is supposed to possess this quality of productiveness, it is dependant upon many other factors. Its profitable employment depends as much upon labour, ability, far-sightedness and experience of those who use it, as upon the favourable economic, social and political conditions of the country. These and many other similar factors are the necessary pre-requisites of profitable employment of capital. If any of the conditions is not satisfied, very often the profitability of capital may become doubtful or even turn into loss.

Even if it is admitted that capital possesses an inherent quality of productiveness which entitles the owner of capital to share in the profit, there is no way of finding out, with certainty and accuracy, the exact amount of prospective profit in order to fix the monthly or annual rate of interest to be paid. Besides, there is no available method of calculating or estimating the profitability of capital ten or twenty years hence and thereby fixing the long-term rate of interest.

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As such, there is no justification for charging a fixed rate of interest on a certain sum of money advanced for ten or twenty years when the actual rate of profit to be made in future is not known.

IV. Theory of the Undervaluation of Future Goods in Relation to Present.

Some economists are of the opinion that man naturally prefers his present wants and their satisfaction to that of the future. They try to explain the phenomenon of interest by their well-known formula of the "under-valuation of future goods in relation to present". Briefly, interest may be called an agio obtained by present goods in exchange for future ones. Boehm, a great exponent of this school, gives three reasons for the under-valuation of future goods :

(*a*) Future profit is doubtful owing to uncertainty of future events and human life, while present gain is certain and visible.

(*b*) The satisfaction of present wants is more valuable for a man than their satisfaction at some future date when he may or may not have those wants.

(*c*) As present goods are practically more useful and employable, they carry a higher value and are regarded superior to future goods.

In view of these reasons, they say that present profit in hand has preference over doubtful gain at some future date. Therefore the value of the loan capital advanced to the borrower today is definitely more than the sum of money he may return some years later. Interest, in fact, is the excess value which is added to the loan capital at the time of payment in order to make it equivalent to the value of the original loan capital. In other words, interest is equal to the (so-called psychological not economic) difference between the present and the future goods.

The question is : Does human nature in fact regard present wants more important and valuable than the future ones ? If so, then why must people not want to spend all their incomes today but like to keep a portion thereof for the future ? One will find many people hold their present wants to keep something for the unforeseen and unexpected events of the future. All human efforts of today are directed to make future better, so that future life may be happy and prosperous. You will hardly find any man willing to make his present happier and prosperous at the cost of his future.

Even if it is admitted, for a moment, that a man is prepared to sacrifice his future good for his present comfort, still the reasoning on which the institution of interest is based and is justified, is not correct. According to this reasoning, the loan transaction between a borrower and a lender shows that £100 of today are worth £105 (£5 being interest) of a year hence. Which means that after one year £105 would be worth £100 of the previous year. If the loan is not paid after one year, then after two years, £100 of the past will be equivalent to £110.

Is this the proportion between the value of the past and the present in actual practice ? And is this principle also valid that as the past is getting older, its value, as compared to the present, is increasing ? There is no convincing answer to these questions.

Maulana Maududi explains the evils and dangers of the institution of interest and shows how it can be harmful and ruinous for society. We will now discuss these moral, cultural and economic evils one by one.

1. Moral and Spiritual Evils

The institution of interest inculcates love for money and the desire to accumulate wealth for its own sake. It makes men selfish, miserly, narrow-minded and stone-hearted. It engenders callousness ; encourages greed : breeds jealousy and entails misery in multifarious ways. To sum it up, it encourages and breeds such qualities among people which are harmful to society.

2. Cultural and Social Evils

It spreads hatred and selfishness which destroy the spirit of social service and breed seeds of discontentment and antagonism

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The question is : Does human nature in fact regard present wants more important and valuable than the future ones ? If so, then why must people not want to spend all their incomes today but like to keep a portion thereof for the future ? One

will find many people hold their present wants to keep something for the unforeseen and unexpected events of the future. All human efforts of today are directed to make future better, so that future life may be happy and prosperous. You will hardly find any man willing to make his present happier and prosperous at the cost of his future.

Even if it is admitted, for a moment, that a man is prepared to sacrifice his future good for his present comfort, still the reasoning on which the institution of interest is based and is justified, is not correct. According to this reasoning, the loan transaction between a borrower and a lender shows that £100 of today are worth £105 (£5 being interest) of a year hence. Which means that after one year £105 would be worth £100 of the previous year. If the loan is not paid after one year, then after two years, £100 of the past will be equivalent to £110.

Is this the proportion between the value of the past and the present in actual practice ? And is this principle also valid that as the past is getting older, its value, as compared to the present, is increasing ? There is no convincing answer to these questions.

Maulana Maududi explains the evils and dangers of the institution of interest and shows how it can be harmful and ruinous for society. We will now discuss these moral, cultural and economic evils one by one.

1. Moral and Spiritual Evils

The institution of interest inculcates love for money and the desire to accumulate wealth for its own sake. It makes men selfish, miserly, narrow-minded and stone-hearted. It engenders callousness ; encourages greed : breeds jealousy and entails misery in multifarious ways. To sum it up, it encourages and breeds such qualities among people which are harmful to society.

2. Cultural and Social Evils

It spreads hatred and selfishness which destroy the spirit of social service and breed seeds of discontentment and antagonism

in society. Instead it helps in the growth of a community in which individuals do not do anything, personal or social, except for profit ; where need of one becomes an apportunity of profiteering for another ; and the interest of the rich is considered opposite to that of the poor. Such a society cannot attain solidarity and cohesion necessary for its success and prosperity, and will, sooner or later, disintegrate.

The same thing is experienced in international relations. It breeds hatred and spreads germs of war among nations. Take for instance, Great Britain, she was in great financial difficulties in the World War II and wanted her rich friends and ally in war to help her with funds without interest. But the Americans did not accede to her request and therefore she had to submit to the conditions laid down in the loan contract known as Bretton Wood Agreement. Though she willingly agreed to the conditions of the loan contract, owing to the pressure of her war requirements, it left a deep feeling of anger and grief in the English Nation which can be noticed from the writings of Lord Keynes, Mr. Churchill and Dr. Dalton. Mr. Churchill called it a "treatment of a tradesman" and Dr. Dalton stated in the House of Parliament, "We requested for an interestless loan but we were told that it was not practical politics".

3. Economic Evils

Interest is paid on different types of loans which lead to different problems according to the nature of loan as well as the debtor. We will therefore discuss each type of loan separately :—

(*a*) *Consumption Loans* : These loans are taken by people in need for their personal needs. Such loans are very common among poor and middle class people, especially in the underdeveloped countries. The majority of these people take loans to meet their day to day needs. And a greater portion of their income is taken over by the capitalist in the form of interest. Millions of people in under-developed countries spend all their lives paying off their inherited debts. Their wages and salaries are so low that, after paying interest, very little is left to enable

them to get even two square meals a day.

This continuous payment of heavy instalments of interest lowers their standard of living and the standard of education of their children. Besides, continuous worry is likely to adversely affect efficiency of their work which may ultimately cripple the economy of a country.

Furthermore, it reduces the already low purchasing power of the working class which, in turn, lowers the demand for goods purchased by them. Thus the industries which meet the demand of the poor and the middle class people will feel the effect of a fall in their demand. And slowly but surely this will slow down industrial development and thereby check economic progress of a community.

(*b*) *Productive Loans* : Loans taken by traders, industrialists and farmers for productive purposes come under this category. The capitalist, by his malpractices, does great harm to the interest of these people and thereby to the community. Some of the evil effects of his malicious designs are enumerated below :

(*i*) A large portion of capital of the community remains idle and unused simply because the capitalist withholds it in the hope of a rise in the rate of interest. Even though there are many useful enterprises and a considerable demand for capital in the market, the capitalist does not release capital in order to obtain higher rate of interest.

(*ii*) It is the greed for higher interest which does not permit the flow of capital into trade and industry according to its natural and real demand. The capitalist releases and withholds funds from the money market according to his own interest.

(*iii*) These malpractices intensify the evil effects of trade cycles which occur periodically in the modern capitalist society and cause great damage to the economy.

(*iv*) Capital is not invested in many enterprises which are very useful and beneficial to the community but are not very profitable.

(*v*) The capitalist does not generally advance long-term loans to trade and industry because of higher profits in speculative

business and in the hope of a rise in interest in future. This attitude of the capitalist, resulting from the existence of interest, is an obstacle in the way of industrial development, especially in under-developed countries.

Besides, a fixed interest on long-term loans is in itself a great evil which sometimes, when profits are low, ruins many flourishing and successful enterprises.

(c) *Government Loans :* Government loans are of two types. Loans acquired by the Government from within the country and those acquired from foreign countries.

(i) *Government Internal Loans :* These loans may be unproductive as war loans ; and may be productive as loans for such enterprises as canals, railways, hydro-electric schemes etc.

In case of unproductive loans, which are acquired for meeting emergencies and other situations, such as famines, earthquakes etc., the position is more or less the same as those of individual loans acquired for personal needs. In fact the position of the capitalist is worse here than in case of individual loans.

The capitalist is such an ungrateful and selfish person that he is charging interest from the Government, which has given him protection and provided him opportunities for attaining this position. If capital is being used for unprofitable but useful needs of the community and will benefit the capitalist as well, the grounds to charge interest cannot be justified.

The situation becomes all the more unforgiveable and criminal when the nation is involved in a life and death struggle with the enemies who have threatened the life and property of the whole community including the capitalist. The entire community is sacrificing the life and property of its members to save its very existence, while the selfish capitalist is demanding interest on war loans. He is not prepared to forgo a single penny from interest, whereas other members of the community are giving the lives of their children, brothers and fathers to protect their honour and their country. How far is it fair and just to feed the capitalist by paying more and more interest, while the whole community suffers, is yet to be answered by the advocates of this doctrine ?

All the burden of interest whether on productive or unproductive loans falls on the poor tax payer through direct and indirect taxes. There are millions of poor people who cannot afford even the bare necessaries of life but have to pay a pound of flesh in interest to the capitalist.

(ii) *Government External Loans :* These loans have all the evils of the personal and national loans whether acquired for productive or unproductive purposes.

Besides, they have another very important and dangerous aspect. They may ruin the internal economy of the country and may also entangle it in international disputes. The heavy burden of external debt is not sometimes only ruinous for a nation but also sows the seeds of hatred and rivalry between different nations which very often result in wars.

External debt may also endanger the security and safety of small and newly independent nations which are not strong enough financially and politically to stand on their own feet.

IMAM RAZI AND INTEREST

Imam Razi has attempted to explain why interest is prohibited in Islam. He has given many reasons supporting the prohibition of interest. Some of his arguments are summarized below :[1]

1. Devouring other people's wealth

The transaction of interest necessitates taking another person's wealth without any consideration or reward. For one who sells one 'dirham' in exchange for two 'dirhams' or one 'wasq' (measure) of wheat in exchange for one and a half 'wasqs' of wheat, on credit or in cash, receives the excess (of dirham or wheat) for nothing. These kinds of transactions are considered unjust and iniquitous. Such transactions, very often, reduce the debtor to poverty through exploitation. The Holy Prophet has clearly stated that a man's wealth is forbidden to another like his blood. It is because of this that extortion of another person's wealth without any reward in exchange for it is

1. Dr. Yusuf-ud-Din, *Islam Kay Muashi Nazriyae.*

prohibited. It may be argued that so long as the debtor keeps the creditor's capital in exchange for a few more 'dirhams' for a fixed period of time, there seems no apparent reason for prohibiting the excess money. Had the creditor kept the capital, which he gave over to the debtor, for his own use, he might have invested it in some business and made some profit. When he leaves his capital in the possession of the debtor, he is unable to derive any profit from it which would otherwise have accrued to him through business. If the debtor pays him some extra 'dirhams' in exchange for the use of his loan capital, it should not be prohibited.

Imam Razi, arguing against this reasoning, emphasises that the profit which the creditor is supposed to make is not a real or a substantial thing. If the creditor, instead of lending his capital to the debtor, were to invest it himself in some business enterprise, he would not be certain of his profit and might actually suffer a loss. Thus the creditor's profit is imaginary and unreal, while the extra 'dirham' (in interest) from the debtor is real and certain.

Interest prevents wealthy people from adopting any profession or occupation because they find it easier to earn their livelihood through interest. They do not like to invest their capital in other commercial enterprises which entail hardship as well as risk. This naturally checks the growth of industry and commerce and thereby slows down the economic progress of a country because worldly affairs cannot continue satisfactorily without trade and industry.

2. Destroys Moral Values

When interest is forbidden, people will abstain from borrowing ; but, if it is made lawful, the needs of people will make them borrow one 'dirham' in exchange for two. As a result, feelings of natural sympathy, human goodliness and gratitude are destroyed.

3. Breeds Hatred and Ill-Will

The poor people, realising that the creditor has been eating

their wealth through interest, curse him and wish evil of him. Thus the institution of interest helps in spreading ill-will and hatred in society.

People naturally feel hatred for anyone who is known to have accumulated wealth through interest and they leave no stone unturned in depriving him of his wealth. His wealth ceases for him after his death but his ignomy and sins remain for ever.

4. The Rich grows Richer and the Poor Poorer

There is every probability in an interestless society that the poor borrower might grow richer and the lender poorer ; but in a capitalist society, the rich grows richer by collecting the wealth of poor through interest, while the poor grows poorer.

It may seem apparent that interest increases wealth of the lender, but in fact, (as shown earlier) it destroys wealth of individuals as well as nations. It applies a brake to investment and lowers the rate of accumulation of capital because the higher the rate of interest the lesser the rate of investment. The fact that interest does not increase but actually decreases wealth was greatly emphasised by the Holy Prophet.

Besides, it is contrary to the spirit of 'sadakat' (charity).

5. Creditor is disgraced

Even if wealth of the creditor does not seem to diminish, his social position in society diminishes a great deal. He loses his respect in the community and is considered an enemy and a parasite, rather than a friend and a benefactor. In short, he is held in bad repute and disgrace by the public. Above all, interest inculcates love for money among the people who amass wealth for the sake of wealth. They lose all sense of justice and become malicious and stone-hearted.

Chapter 4

PROHIBITION OF INTEREST IN THE HOLY QURA'N

1. Introduction

In order to fully understand the doctrine of interest as contained in the Holy Qur'an, it is absolutely essential that the reader should look at the injunction of the Holy Qur'an with an open mind and without any pre-conceived ideas or prejudices against the teachings of Islam.

There is no doubt that the economists have written a great deal about the doctrine of interest but 'only as a multitude of scattered observations' without presenting a consistent and systematic theory. And we won't be wrong if we say that the economists, in spite of their great intellectual achievements in the field of economics, have failed to solve the problem of interest. They have, in fact, avoided the real issue as to why interest should be paid and they have spent all their energies in finding out how interest is determined? Thus, from our point of view, the very hypothesis on which they have built a huge superstructure of scores of interest theories, is wrong and fallacious.

Furthermore, it is also necessary that the reader should look at the doctrine of interest as one of the five pillars of the economic system of Islam (others being, Sadakat, Zakat, Prohibition of unnecessary and excessive accumulation of wealth and laws of inheritance). If it is studied as a separate institution, and not as a component of the economic system of Islam, it may not only lose some of its significance but may also give rise to doubts about the validity of some of our arguments. Though

the doctrine of interest is a component of the economic system of Islam and, as such, presents a true picture only when studied with other components of the system, it will provide interesting and useful information to any reader by itself.

2. The Holy Qur'an

The institution of interest had become a part and parcel of the economic system of the people of Arabia like that of other countries of the world. It was, in fact, regarded essential for the successful operation of the existing economic system by the people. But Islam considered it an economic evil which had been spreading its harmful effects in the economic and social life of the whole community. Therefore, the Holy Qur'an declared interest unlawful in the Muslim community. As it was deeply rooted in the economic life of those people, God in His All-Knowing wisdom, revealed His commandments about the prohibition of interest (like that of the prohibition of alcohol) gradually so that it might not upset the economic life of the people and cause unnecessary inconvenience and hardship to them.

We will now discuss the injunctions of the Holy Qur'an on interest in the following :

(1) The first injunction of the Holy Qur'an lays stress upon the fact that interest does not increase individual or national wealth, but, on the other hand, it decreases wealth :

> "And whatever you lay out at interest, so that it may increase in the property of men, it increases not with God." (30 : 39)

(2) In the next injunction, the Muslims are told not to take compound (usury) interest if they want real success in life :

> "O you who believe, devour not interest doubling and redoubling, and keep your duty to God ; that you may be successful". (3 : 129)

(3) Next injunction distinguishes between trade and interest (Riba) and points out that interest, in fact, destroys national wealth of a country. Then it admonishes the believers to refrain from interest (*i.e.* taking interest) or else they shall suffer

evil consequences both in this world and the Hereafter :

> "Those who swallow interest cannot rise except as he arises whom the devil prostrates by (his) touch. That is because they say, trade is just like interest. And God has allowed trading and forbidden interest. To whomsoever then the admonition has come from his Lord, and he desists he shall have what has already passed. And his affair is in the hands of God. And whoever returns (to it)—these are the companions of the Fire : Therein they abide".
>
> "God has blotted out interest and caused charity to prosper. And God loves not any ungrateful sinners".
>
> **(2 : 275-276)**

(4) And then the final injunction of the Holy Qur'an, prohibiting interest and declaring it unlawful in a Muslim society, was revealed to the Prophet Muhammad (PBUH) :

> "O you who believe, keep your duty to God and relinquish what remains (due) from interest, if you are believers".
>
> "But if you do (it) not, then be appraised of war from God and His Messenger ; and if repent, then you shall have your capital. Wrong not, and you shall not be wronged". (**2** : 278)

(5). In the following verse of the Holy Qur'an, the Muslims are warned to obey the injunctions regarding interest, as contained in the Book, or else they shall suffer the same fate as the Jews, who were forbidden (to take) interest, but they continued taking interest :

> "And for their taking interest—though indeed they were forbidden it—and their devouring the property of people falsely. And We have prepared for the disbelievers from among them a painful chastisement".
>
> **(4 : 161)**

3. Hadith

In order to show how the Holy Prophet explained and clarified the meanings of the various injunctions of the Holy

Qur'an regarding the Prohibition of interest to his companions, we will quote here some of the important sayings of the Prophet :

(1) It has come down from 'Aun ibn Hanifa, who reported from his father that the Holy Prophet had condemned both the receiver of interest and its payer.[1]

(2) 'Abdullah Ibn Mas'ud reported that the Holy Prophet cursed the receiver of interest as well as its giver ; the scribe of the interest deed, and the witnesses to it and further said that they all are equal (in the act of committing sin).

(3) According to Jabir, the Holy Prophet cursed those who receive interest, pay interest and the scribe of the deed and those who bear witness to it.[2]

(4) Then the Holy Prophet, on his last Pilgrimage and in his last address, said, "Every form of interest 'Riba' is cancelled ; capital indeed is yours which you shall have, wrong not and you shall not be wronged. God has given His injunctions that interest is totally forbidden. I first start with (the amount of) interest (which people owe) to 'Abbas and declare it all cancelled". He then on behalf of his uncle, 'Abbas, cancelled total amount of interest due on his loan capital from his debtors.[3]

4. Significance of these Injunctions

A careful study of these verses of the Holy Qur'an and the sayings of the Holy Prophet presents us with the following problems concerning interest :

(1) Meaning of 'Riba' (interest).

(2) What is a fair rate of interest, or the traditional difference between usury and interest ?

(3) Difference between trade and interest.

(4) Is interest a natural phenomenon in the economic system or merely a creation of institutional and conventional factors ?

(5) Why interest should not be paid ?

1. *Bukhari*.
2. *Muslim*.
3. Imam Malik, *Muatta*.

(6) Is interest beneficial or harmful to society ?

(7) A society without interest is likely to prosper at a faster rate than that with a rate of interest.

(8) Various economic factors are likely to lower the rate of interest.

(9) Economic necessity will gradually push the rate of interest down to a very low level approaching zero.

(10) Possibility of a zero rate of interest :

(*a*) Keynes views on interest.

(*b*) Islamic conception of interest.

Let us deal with these problems one by one.

Chapter 5

MEANING OF 'RIBA'

The Holy Qur'an has used the word 'Riba' for interest. The dictionary meaning of 'Riba' is excess or increase or surplus but, in economics, it refers to that surplus income, which the lender receives from the borrower, over and above the principal amount, as a reward for waiting or parting with the liquid part of his capital for a specified period of time.

'Riba', in Islam, particularly refers to that excess which is demanded in a particular way. Ibn Hajar 'Askalani, talking of 'Riba' says, that "essence of 'Riba' is excess whether it is in the commodity (itself) or in money, as two dinars in exchange for one dinar. According to Allama Mahmud al-Hassan Taunki, 'Riba' means excess or increase ; and when, in a contract of barter (exchange of goods for goods), more of one thing is demanded in exchange for exactly similar thing, it is called 'Riba'.

In the words of Shah Wali Ullah of Delhi, element of 'Riba' exists in the debt which is advanced on the condition that the borrower will pay more or better than what he has received from the lender. In the opinion of Abu Bakr Ibn al-Arabi, every excess is 'Riba' in return for which no reward is paid.[1] Qatada says that pre-Islamic 'Riba' was this that one person sold goods to another person for a specified period, when the period expired and the buyer had not made the payment, then the seller would extend the time of payment along with increase in the purchasing price (to be paid back)".

According to Mujahid, element of 'Riba' existed in all the

1. Dr. Yusuf-ud-Din, op. cit., p. 391.

dealings of this nature in the pre-Islamic days: whenever a person contracted a loan from someone, he would ask the creditor to give him more time for payment, and that he would, in return, pay him a fixed amount in excess of the principal loan.[1]

The findings of Abu Bakr Jassas also show that whenever people in the pre-Islamic times contracted loans from one another, it was agreed upon between the parties concerned that so much amount of money (a definite sum) would be paid by the borrower in excess of loan after a certain specified time.[2]

In the opinion of Imam Razi this was the custom in the pre-Islamic times that they advanced a sum of money to a person for a specified time and received from him a fixed amount of money every month as interest; when the time expired, the borrower was asked to repay the debt, if he could not repay the debt, he was given extension in the time for repayment and the interest was increased".[2]

Such forms of loan business were in vogue in Arabia in those times and were called by the name 'Riba'. It is this surplus or excess over principal amount which is prohibited in Islam.

A careful study of 'Riba' will show that it is not the same as usury but is inclusive of all excess over and above the principal sum lent including usury. 'Riba' is earned when a man lends his capital to another on the condition that after a certain time he would charge a fixed amount of money in addition to his capital. This additional amount, which is 'Riba' (or interest), is a consideration not of any labour or commodity but of the time for which the principal has been borrowed.[3]

'Riba', in essence, is thus an amount charged on the principal as a consideration for the time during which the principal is to be used and it consists of three elements, viz., addition to the principal, the rate of that addition according to time, and the

1. *Interest*, op, cit Vol. I, p. 33.
2. *Ibid.*
3. Maulana Abul Ala Maudoodi, quoted by Abdul Majid in Holy Qur'an, Vol. I, pp. 90-92 and 96-97.

payment of the additional amount being a condition of the bargain. All transactions including these three elements come under the category of 'Riba'.[1]

In fact, the "Arabic 'Riba' is but partially covered by the English word 'usury' which, in the modern parlance, signifies only an exorbitant or extortionate interest. The Arabic 'Riba' on the other hand, means addition, however slight, over and above the principal sum lent, and thus includes both usury and interest".[1]

"All the injunctions do not imply that the form of interest known as usury alone was to be abolished and other forms to be maintained. They really aimed at eradicating the mentality, the ethical standards, the culture and the economic organisation of capitalistic system and to establish a new system in which niggardliness should give place to charity, selfishness to sympathy and co-operation, 'Riba' to 'Zakat', Banking to 'Bait-ul-Mal' and thus to obviate the circumstances which may give rise to co-operative societies.[1]

After studying the various forms of business and credit transactions, containing the element of 'Riba', which were in vogue in Arabia during the time of the Holy Prophet, interest may be defined as a pre-determined excess or surplus over and above the loan capital received by the creditor conditionally in relation to a specified period.[2] It contains the following three elements:

(1) Excess or surplus over and above the loan capital.
(2) Determination of this surplus in relation to time; and
(3) Bargain to be conditional on the payment of a predetermined surplus.

These three elements jointly constitute 'Riba' and any deal or bargain or credit transaction, in money or in kind, which contains these elements, is considered a transaction of 'Riba' by the Muslim jurists and economists.

1. Maulana Abul Ala Maududi, quoted by Abdul Majid in Holy Quran, Vol. I, p. 90-92 and 96-97.
2. *Interest*, op. cit. Vol. I, p. 33.

The above-defined 'Riba' has been classified into two groups :

(i) 'Riba Nasia' and (ii) 'Riba al-Fadl'.

(i) Interest in Debt 'Riba Nasia'

This type of 'Riba' was quite wide spread and well-known in the time of the Holy Prophet. It was found in all those credit transactions where a loan was advanced to a person on the payment of a monthly interest over and above the principal. At the expiry of the period of debt, the creditor would ask for the repayment of his principal ; and if the debtor was unable to repay it, the former would extend the period of payment on the condition that the latter would pay a certain additional sum of money which was determined at the time of the transaction.

The transactions of this nature were very common in Arabia in those days and they all contained an element of 'Riba' (interest).[1] Whenever "a debtor could not repay the principal with the accumulated surplus (interest) at the time it fell due, he was given an extension of time in which to pay the loan, but, at the same time, the sum due was doubled".[2]

"The 'Riba' in pagan Arabia lay in that the creditor demanded at the time fixed for payment of debt his dues from his debtor. If the latter complied, the principal advanced would be received and the debt discharged. But if the debtor was unable to pay, 'easing time' was granted to him on consideration of an additional sum".[3]

"Pagan Arabs advanced loans for a fixed time. When that time lapsed, the creditor demanded repayment of his dues or interest thereon from his debtor. If the debtor was unable to pay, the amount of the loan would then be doubled".

The following examples from the time of the Holy Prophet may help to clarify the meaning of 'Riba' Nasia (interest in money transactions) :

1. Dr. Yusuf-ud-Din, op., cit. p. 391.
2. *Shorter Encyclopaedia of Islam*, London, 1953, p. 471.
3. Anwar Iqbal Qureshi, *Islam and the Theory of Interest*, p. 65.

(a) Abu Saleh said that he sold his cloth to the people of "Dar-un-Nakhla" on a promise to pay after a specified date. But later on, when he was going to Kufa, they asked him to reduce the sum fixed earlier and they would pay the money in cash now. He consulted Zaid Ibn Thabit about that but was refused permission to accept the offer for there was an element of 'Riba' in it.[1]

(b) 'Abdullah Ibn 'Umar was asked about a person who had lent some money to another person for a specified period ; the borrower had requested the creditor to reduce the sum due and that he would repay it just then (i.e., before time), but 'Abdullah disliked it and forbade not to accept the offer for there was doubt of the element of 'Riba' in it.[1]

(c) According to Zaid Ibn Alsam, in the ancient Arabia, 'Riba' was in this form : when a person owed some money to another person and the period of debt expired, the lender would demand his principal sum ; if the debtor expressed his inability to pay, the lender would then grant him an extension on the condition that he would pay in excess of the capital. The period was then extended with an increased debt (as a reward for extending the period of debt). Thus it was more or less a reward for waiting for a longer period to receive the principal back from the debtor and the sum which was charged over and above the capital lent was called 'Riba' (or interest).[1]

(d) Imam Malik says that there is complete agreement among the Muslim jurists (and economists) regarding the prohibition of all credit transactions, where some one gives a loan to another person for a fixed period but the borrower repays (or promises to repay) the sum due before the specified date when the creditor reduces the time of loan due ; or when the creditor, increases the time of repayment after the expiry of the period of loan and the debtor (promises) to increase the amount of his debt by a fixed additional sum. According to Imam Malik, it is pure interest and there is no doubt about it.[1]

Imam Malik further says that if a certain person owes 100

1. Imam Malik, *Muatta*.

dinars to another person and the time of repayment has expired and the debtor requests the creditor to sell to him something worth 100 dinars for 150 dinars for a specified period. This sale is not valid and the jurists have always forbidden it for the creditor has received the price of 100 dinars for his commodity and has increased the period of repayment of the debt of 100 dinars for 50 dinars which is similar to 'Riba'.[1]

Commenting on 'Riba', Imam Razi says, "The creditor who has loaned out a certain amount to another person for a stated time, goes to his debtor when the time for repayment arrives. If the debtor has no money for repayment of his debt, he requests for an extension in the time of payment on certain addition. The creditor agrees. This is strictly forbidden in Islam."[2]

"In Pagan times, if a debtor owed 100 dinars to his creditor and the former had no means to repay the debt at the expiry of the stated time, the creditor stipulated certain increase or addition in his principal, on the consideration of which he would agree to extend the time of payment. This is not allowed in Islam".[2]

In all a these exmples quoted above, an element of 'Riba' (called 'Riba Nasia' or interest on debt) existed and therefore they were strictly forbidden in Islam.

(ii) Interest in Barter 'Riba al-Fadl'

'Riba al-Fadl' is the excess over and above the loan paid in kind ; it lies in the payment of an addition by the debtor to the creditor in the exchange of commodities of the same kind i.e., wheat for wheat or barley for barley or grapes for grapes etc.

Barter transactions were very common in Arabia, like many other countries, in those days. People used to exchange goods for goods ; it was a common practice among the poor to borrow a certain quantity of cereals from the rich, in the village or town, with a promise to pay more after a certain specified time. This is quite similar to the case referred to above, where a man borrows 100 dinars with a promise to pay 150 or 200

1. Imam Malik, *Muatta.*
2. Anwar Iqbal Qureshi, *op. cit., pp. 66-67*

dinars after a certain specified period. The nature of both the bargains is almost identical ; the difference is in form only. In the first case more cereals are paid in exchange for less and in the second more money is paid. All such bargains contain an element of 'Riba'.

The Holy Prophet, therefore, did not confine the application of 'Riba' to credit transactions in money only, but to cover all other forms of of barter sales (or purchases) of commodities as shown in the following Hadith :

(1) 'Umar reported that the Holy Prophet said : "To sell wheat for wheat, barley for barley, dates for dates is 'Riba' except when sold from hand to hand (i.e., transaction is completed on the spot)".[1]

(2) According to Abu Saeed Khudri, the Holy Prophet said, "Sell not two 'saa' (measure) of dates for one 'saa' nor exchange two dirhams for one dirham (for it is 'Riba')".[1]

(3) It is related by Abu Bakr that the Holy Prophet said, "Sell not gold for gold and silver for silver but in equal quantity ; but sell gold for silver or silver for gold as you please".[1]

(4) It is reported by Abu Saeed Khudri that the Holy Prophet said, "Sell not gold for gold and silver for silver but in equal quantity nor sell anything for the same thing in lesser quantity, nor sell anything present for that which is absent."[1]

(5) It is related by Abu Huraira that the Holy Prophet said, "Sell one dinar in exchange for one dinar and one dirham in exchange for one dirham and not for more".[2]

(6) 'Uthman reported that the Holy Prophet said, "Sell not one dinar for two dinars, nor one dirham for two dirhams".[2]

(7) It is reported by 'Ubadah Ibn Samit that the Holy Prophet said, "Exchange gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, in equal quantity and hand to hand (i.e., on the spot). But if there is difference in kind, then sell them as you please, hand

1. *Bukhari.*
2. *Mautta*, op. cit.

to hand (but not on credit)".[1]

(8) Abu Said Khuddri relates from Abu Huraira that the Holy Prophet appointed a person as Governor of Khaiber. He brought superior quality dates to the Holy Prophet, who said, "Does Khaiber produce similar dates throughout the land ?" He replied, "No. By God, we purchased one 'saa' of this variety of dates in exchange for two 'saa' of another variety." The Holy Prophet said, "Do not do so (again) ; you should first sell these dates at the market rate for money and then purchase superior quality dates".[2]

(9) Abu Said says that one day Bilal came to the Holy Prophet with green variety of dates. The Holy Prophet enquired, "Where from did you bring this ?" Bilal replied, "We had dates of inferior quality ; we therefore gave two 'saa' of that quality in exchange for one 'saa' of this (superior) quality with the object of presenting to the noble Prophet". On hearing this the Holy Prophet exclaimed, "A Wa A Wa (expression of condemnation). This is clear interest. Do not do so (again), rather when you wish to acquire dates of superior quality, first sell the dates of inferior variety for money, and then purchase dates of superior quality".[2]

To sum up, element of 'Riba' (interest) lies in exchange of commodities of the same kind in varying quantities.

These sayings of the Holy Prophet bear evidence to the fact that an element of 'Riba' is found not only in money transactions but also in all forms of barter transactions in which one person receives an excess over and above the commodity exchanged.

The following principles for determining the existence of 'Riba' in credit or barter transactions can be derived from the above sayings of the Holy Prophet :[3]

(*a*) Exchange of things, of the same kind and same value, in

1. *Muatta*, op. cit.
2. *Bukhari*, quoted by Anwar Iqbal Qureshi, *Islam and the Theory of Interest*, pp. 71-72.
3. *Interest*, op. cit. Vol. I, pp. 43-45

unequal quantities, on credit or cash, contains an element of 'Riba'. For example there is an element of 'Riba' in the exchange of an ounce of gold for one and a half ounce of gold.

(*b*) Exchange of things, of the same kind but different in value, in unequal quantities, on credit, contains an element of 'Riba'. But such an exchange is free of 'Riba' when completed hand to hand (i.e., on the spot).

(*c*) Exchange of things, of the same value but different in kind, in unequal quantities, on credit, contains an element of 'Riba' ; but when the deal is completed hand to hand, it is free of 'Riba'. For example, if one ounce of gold is equal in value to one pound of silver, then hand to hand deal will be permissible but this transaction will not be permitted on credit because of the element of 'Riba'.

(*d*) Exchange of things, which differ both in kind and value, in unequal quantities, on credit as well as hand to hand, is free of 'Riba' and, therefore, permissible. For example, salt and wheat may be exchanged, hand to hand or on credit, in any quantities agreed upon between the parties.

(*e*) If the mixture of some things changes their kind and value, exchange in unequal quantities both on credit and hand to hand is free of 'Riba' and therefore, permissible. For example, any ornament of gold in exchange for gold or wheat in exchange for wheat flour.

(*f*) Under money economy, where prices are determined in terms of the standard coin of the country, exchange of the same thing in unequal quantities, both on credit and hand to hand, is free of 'Riba' and therefore, permissible. For instance, one grade of wheat is sold at 10 pounds per dollar, while another grade is sold at 15 pounds per dollar. These two grades of wheat, in spite of the sameness of the kind, may be exchanged in unequal quantities without any fear of 'Riba' because the transaction is made in terms of the price of wheat, not by its kind or weight.

The Muslim jurists, after studying these sayings of the Holy Prophet, concluded that the statement of the Holy Prophet was merely explanatory and, therefore, all those commodities which

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possessed the characteristics of the commodities mentioned by the Holy Prophet (*i.e.*, gold, silver, dates, wheat, barley and salt) should also be covered by the regulations, governing 'Riba' transactions, both hand to hand as well as credit. [1]"But they differed from one another in their lists of these things. According to Malikis and Shafi'is gold and silver represent the clans of precious metals (which are used as media of exchange, whether gold or silver or any other thing) and the four other things (wheat, barley, dates and salt) the class of foodstuffs; the latter, in the Maliki's view, include actual eatables so far as they are preserved; according to the older view of al-Shafi'i, provisions which are sold by weight and measure; according to his later view, which is also that of his school, foodstuffs without any qualifications".

[1]"According to Hanafis and Zaidis (also Al-Awzai) gold and silver represent examples of the class of things defined by weight (Mawzun) and other four things those sold by measure (Makil). The teachings of the Hambalis correspond to that of the Hanafis; as regards the four kinds: two further opinions of Ahmad bin Hambal are handed down which correspond to the two views held by Al-Shafi'i".

(iii) Concluding Remarks on 'Riba'

"The prohibition of 'Riba' plays a considerable part in the system of Muhammadan Law. The structure of the greater part of the law of contract is explained by the endeavour to enforce prohibition of 'Riba' and 'Maisir' (i.e., risk).

'Riba' in a loan exists not only when one insists upon the repayment of a larger quantity but if any advantage at all is demanded. Therefore even exchange 'suftadja' is sometimes disapproved (as by Hanafia), sometimes actually forbidden (as by Shafi'is) because the vendor, who is regarded as the creditor reaps the advantage of avoiding cost of transport."[1]

This long discussion about 'Riba' shows very clearly how great care has been taken to determine the element of 'Riba'

1. *Shorter Encyclopaedia of Islam*, op. cit., p. 472.

and hence the validity of any business transaction so that no injustice is done to any party. All such bargains, whether involving money matters, or barter transactions, hand to hand or on credit, in which there is probability of excess over and above the principal loan or commodity, are said to contain an element of 'Riba' and are, therefore, not permissible in a Muslim community.

There are many (the so-called Modern) Muslims, who are ignorant of the fundamental teachings of Islam but are greatly influenced by the Western education and culture. They are deeply impressed by the industrial and banking development of the European countries and are beginning to criticise some of the cardinal principles of Islam without even knowing them.

The doctrine of interest, as referred to by the word 'Riba' in the Holy Qur'an, is one of those subjects, which have been misunderstood or deliberately misinterpreted and wrongly criticised by some modern Muslims who may have never read the Holy Quran in their life. The following passage is a very appropriate answer to their misinterpretation of 'Riba'.

> "If people had not indulged in wishful interpretation of these verses of the Holy Qur'an (regarding 'Riba'), it should have been unnecessary for us to consider further what is that exceess, unsury or interest, which the Qur'an so forcefully prohibits. But, unfortunately, people have too often let their fancy play a leading part in the interpretation of the verses. It has been particularly so since the advent of the industrial revolution when capital came to play a leading role in the industrial and commercial fields. Intellgent Musalmans in the nineteenth century saw on the one side the long strides that the West, helped by its banking structure, was taking in the domains of industry and commerce, and on the other, the ignorant and lethargy Musalmans dragging them rung by rung down the ladder of prosperity. They saw that banks were an indispensable equipment in the industrial and commercial mechanism. Musalmans could not advance without commerce and

industry. Commerce and industry could not advance without banking. Therefore Musalmans should no longer shun interest, the basis of banking. But what about the Qur'an which prohiblts interest ? It was with this line of argument that (some well-known) men (of learning) approached the Qur'an. They, therefore, translated the word 'Riba' as usury and proceeded (without fully realising the economic and social significance of the word 'Riba') to differentiate it from interest. Usury, they said, refers to the primitive form of money-lending when money was advanced for consumptional purposes".[1]

"But they forgot several things which repudiate their argument. Even in the days of the Prophet the Jews of Medina advanced money not only for consumptional purposes but also for trade. Similarly, modern banks advance money not only for productive purposes but also for consumptional purposes. In fact, the essential difference between the loan transactions of the Jews of Medina and modern banking is one of degree and development, not of kind. The most important thing is that this bearing of banking on commerce was known to the Arabs even during the Prophet's days".[1]

"So far as the alleged difference between usury and interest is concerned, there is nothing in the verses of the Qur'an to justify it. As already pointed out, the word in the original is 'Riba' which means excess or addition and therefore it covers both interest and usury."

"There are people who would not like to change their own views but would change the meaning of the verses of the Holy Qur'an to suit their own whims. And, as such, they would accept that definition of 'Riba' which would fit in their modern views. One of such

1. Shaikh Mahmud Ahmad, *Economics of Islam*, pp. 20-24.

gentlemen remarked that, "the definition I would accept would be : undue profit made, not in the way of legitimate trade, out of loans of gold and silver, and necessary articles of food, such as wheat, barley dates and salt (according to the list mentioned by the Holy Prophet himself). My definition would include profiteering of all kinds, but exclude economic credit, the creature of modern banking and finance".

"It is surprising that most of these 'moderns' would blindly accept anything that comes from the 'West' without any argument : but would criticise every little thing that is presented to them in the name of Islam. This criticism is not based on any genuine desire, on their part, to understand the problem under discussion but merely to ridicule it."[1]

[1]"The honourable critic of 'Riba' seems to be such a "modern". Without quite understanding the meaning of 'Riba' and its historical usage, he has taken great pains to give a new meaning to the term. It is indeed correct that all-embracing word 'Riba' is capable of including profiteering. But why should the learned translator consider interest-bearing loans of gold and silver objectional and bless currency loans "the creature of modern banking and finance", passes one's comprehension. What difference is there, moral or technical, between a gold loan and a currency loan ? Before the institution of paper money, gold, at first unminted and later on minted, was the medium of exchange and the measure and store of value. The same important functions are now performed by paper money backed by bank or state credit plus a certain percentage of paper money kept as gold reserve. In the primitive days, loans were advanced in the form of precious metals or coins made therefrom ; now loans are advanced in the form of cheques or notes. The Qur'an is not concerned

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with the shape of our loans. It is concerned only with the "excess"—call it interest or usury or what you like—that we may charge or pay for the use of a loan. If we do not abstain, we are free to 'take notice of war from God and His Apostle."

"It is, indeed, the same old habit of teaching the Qur'an a little economics. They have presumed that God knew a little more of it. What they should have said was : Of course, the Qur'an prohibits all forms of interest, but the Qur'an is an obsolete book incapable of satisfying modern requirements. That would have been a more straightforward statement. If they said that, one could have referred them to the man who understood Money and Interest more than anyone else in this century". This is what Lord Keynes writes :

"There remains an allied, but distinct, matter, where, for centuries, indeed for several millenniums enlightened opinion held for certain and obvious a doctrine which the Classical School has repudiated as childish, but which deserves rehabilitation and honour. I mean the doctrine that the rate of interest is not self-adjusting at a level best suited to the social advantage but certainly tends to rise too high, so that a wise Government is concerned to curb it by statute and custom and even by invoking the sanctions of the moral law".[1]

(*iv*) 'Riba' and Usury

It is needless to waste time in defining interest and usury because both the words are inter-changeable and are used for the addition or excess paid (or received) over and above the loan capital. ISLAM, without making any distinction between interest and usury, prohibits 'Riba' which is a very wide term and is inclusive of both interest and usury. Thus the present day banking interest comes within the definition of 'Riba'.

1. Keynes, *General Theory*, op. cit.

It will be interesting to study the meaning of usury as given by the Oxford Dictionary. It defines usury in these words : "Practice of lending money at exorbitant rates of interest especially at higher interest than is allowed by law". According to this definition any "excessive rate especially above the rate fixed by the Government is a usurious rate of interest. In this respect the lead given by Islam is most clear and enlightening and puts all sorts of manoeuvring of money-lenders to an absolute end. Islam has fixed a zero rate of interest (as its legal rate) and any rate above the zero rate is a usurious rate of interest"[1] in a Muslim community.

(*a*) Usury Condemned by All

It may be said, without any fear of contradiction, that prohibition of 'Riba' applies to interest as understood by the common man. It is this simple interest (including banking interest) which is condemned and forbidden by Islam. As for usury, which is the worst form of interest, it has been condemned unanimously by all religious and well-known philosophers in all ages. Even the Jews, who sanctioned interest, prohibited usury. The Christian Fathers declared usury as immoral. The ecclesiastical ban on usury continued until the end of the Middle Ages so that, as late as the 13th century, the St. Thomas Aquinas was able to say : "To take usury for money lent is unjust in itself, because this is to sell what does not exist".

Antoninius of Florence condemned usury in these words : "Money is not profitable itself alone, but it may become profitable through its employment by merchants". Therefore he condemned any gain in the form of a usurious rate from such unprofitable money. A number of scholastic writers developed this line of reasoning and condemned usury.

The hero of the ancient world, who led the attack on usury, was Aristotle. He was foremost in condemning usury. In his words :[2] "Of the two sorts of money-making one, as I have just

1. *Islam and Theory of Interest*, op. cit., p. 139.
2. Aristotle, *Politics*, pp. 23 and 111.

said, is a part of household management, the other is retail trade: the former necessary and honourable, the latter a kind of exchange which is justly censured; for it is un-natural, and a mode by which men gain from one another. The most hated sort, and with the greatest reason, is usury, which makes a gain out of money itself, and not from the natural use of it. For money was intended to be used in exchange, but not to increase at interest. And this term usury, which means the birth of money, is applied to the breeding of money, because the offspring resembles the parent. Wherefore of all modes of making money this is the most un-natural".

Many economists, who ordinarily justified interest strongly objected to usury.[1] All the mercantilists emphasised the usefulness of low rate of interest and attacked high interest rates (usury).[2] Sir William Petty supported the low interest rate but condemned usury. Sir Josiah Child also favoured low rates of interest but condemned usury.[3] Sir Thomas Culpepper stated that high rate of interest made people grow lazy in their profession and become usurers.[3] He also argued that low rate of interest would enable improvements in agriculture and thereby revive our dying manufacture. Hume, after stating the well-accepted doctrine of his age that a "low rate of interest was the surest sign of the flourishing state of a country's trade", rejected the idea of a usurious rate of interest.[4]

(b) Interest and Usury Inter-Changeable

A study of the historical development of the concept of interest shows that even in olden times interest as well as usury was regarded by most of the canonists, philosophers and economists as a charge over and above the loan capital and the two terms were often inter-changeable. A cursory glance at the writings of those people will show that the two terms are inter-changeable and easily shade into one another.

1. E. Roll, *A History of Economic Theory*, p. 98.
2. *Ibid* p. 108.
3. G. Cassel, *Nature and Necessity of Interest*, p. 10.
4. E. Roll, op. cit. p. 119-120.

For instance, a well-known canonist, Cozelez Tellez writes : "So then, as money breeds no money, it is contrary to nature to take anything beyond the sum lent, and it may with more propriety be said that it is taken from industry than from money, for money certainly does not breed, as Aristotle has related. The goods loaned pass over into the property of the debtor. Therefore the use of the goods for which the lender collects interest (i.e., usury) is the use of another person's goods, and from that the lender cannot draw a gain without injustice. For the creditor who gains from a thing belonging to another person enriches himself at the expense of another".[1]

Vaconius Vacuna is more outspoken in his concluding remarks about usury : "Therefore he who gets fruit from that money, whether it be pieces of money or anything else, gets it from a thing which does not belong to him, and it is therefore just as if he were to steal it".

Thomas Aquinas contends that [2]"there are certain things the use of which consists in the consumption of the articles themselves, such as grain and grapes etc. On that account the use of these things cannot be separated from the article themselves, and if the use is to be transferred, the article itself must necessarily be transferred with it : Therefore, when an article of this sort is lent, the title to it will always be transferred as well. Now it would be patently unjust if a man should sell grain, and yet, as a separate thing, sell the use of grain, too. In so doing, he would either be selling the same article twice or he would be selling something which does not exist. Exactly in the same way it is unjust for a man to lend things of this sort at interest. Here also he is asking two prices for an article ; he is demanding that it be replaced by a similar article and he is also asking a price for the use of the article. That we call interest or usury. Since the use of money, too, consists in consuming or spending it, it is inadvisable in itself, on the same grounds, to ask a price for the use of money (whether for consumption or production purposes)".

1. Boehm Bawerk, *The Positive Theory of Interest*, p. 13.
2. *Ibid.*, p. 14.

Thomas Aquinas further argues that "interest is to be regarded as the hypothetical and underhand price asked for a possession common to all, namely, time. The usurers claim that time is recognised as the equivalent for which they receive the surplus income which is interest. Thus they sell time which belongs to the borrower just as much as it does to the lender and all men".[1]

All these writers have not only condemned but made it explicitly clear that interest and usury are, in fact, words used to convey the same meaning ; they are interchangeable words and easily shade into another. According to them, any amount charged over and above the original loan capital is called usury or interest, and is unjust.

(c) Fair rate of Interest

It is evident from the above discussion that the exorbitant interest rates have been condemned by all religious leaders, philosophers and even economists of all countries throughout the history of mankind. There seems to be complete agreement among the canonists, philosophers and the economists that higher interest rates are unjust.

Even, if, for the sake of argument, we agree to the views expressed by the latter group of writers that usury refers to exorbitant rate while interest to ordinary low rate charged by the banks and the capitalists, now the question arises what is a usurious rate and what is interest ? How to distinguish between a usurious rate and an ordinary fair rate of interest ? It is very hard to tell that particular interest is usurious and the other is a fair rate. Besides, what is considered a fair rate by one authority at one time may be considored a usuraus rate by the same authority at another time or by another authority at the same time.

Thus it seems that the difference in the two terms is not of kind but of degree, which may easily change in course of time (or place) ; for what is considered usury today may be regarded a reasonable rate of interest tomorrow and similarly what is considered a reasonable rate of interest today may be regarded

1. B. Bawerk, op. cit., p. 13.

as a usurious rate tomorrow. During the reign of Henry VIII anything over 10% was regarded usury but under 10% was considered a fair rate of interest. While in 1624, 10% was regarded a usurious rate and 8% was a fair rate ; by 1651, 8% became a usurious rate and 6% a fair rate ; and under Queen Anne over 5% was regarded a usurious rate whereas 5% was considered a fair rate of interest.[1]

Islam, therefore, makes no distinction between interest and usury and condemns both by the name 'Riba'.

(d) Reasonable Rate of Interest

[2]In spite of the absurdity of the various theories of interest, this institution is well established in the Western capitalist system and the whole problem now revolves round the point that the rate of interest should be reasonable. No one ever touches the real problem whether interest is in itself a just and equitable institution ? The only thing the economists and other writers point out is whether a certain rate of interest is reasonable and therefore acceptable ; or unreasonable and therefore unacceptable.

We ignore for the time being the basic problem how the institution of interest, which in itself cannot and has not been proved just and reasonable, can have a reasonable and equitable rate ? Leaving aside the real issue, we confine our attention to the problem whether there is any reasonable rate of interest ? What is that rate of interest which can be called natural and reasonable ? And what is the standard for judging one rate as reasonable and another as unreasonable ? Besides, is the actual rate of interest in the world determined according to some rational principles ?

When we analyse the first question we find that such a thing as "a reasonable rate of interest" has never been found in the world. Different rates of interest have been termed as reasonable at different times ; and the same rates have been afterwards declared as unreasonable at another place at the same time.

1. Anwar Iqbal, op. cit. p. 4.
2. Maulann Maudoodi, *Interest*, Vol. I and II.

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1. Anwar Iqbal, op. cit. p. 4.
2. Maulann Maudoodi, *Interest*, Vol. I and II.

During the ancient Hindu period a rate between 15 to 60% was regarded quite reasonable and just and could be raised if the risk involved was greater. During the 18th and 19th centuries the usual rate (which was considered reasonable) was 48%. During the World War II, Government obtained war loans at 2% which were quite reasonable at that time.

The same trend was experienced in other countries of the world. A 10% rate of interest was regarded reasonable during the middle of 16th century in England but now everywhere this is considered as robbery not interest. Now the usual rate of interest is 2½ or 3%, sometimes it comes down to ¼ or ½ or 1%. Which one of these rates is natural or reasonable? It is very hard to tell.

Can in fact there be a reasonable and natural rate of interest? A little thought would have shown that a reasonable rate of interest could only be fixed if it were possible to judge the exact value of the remuneration that would have accrued to the borrower from the loan capital. For instance, if it could be fixed that £100 would bring a profit of £25 in one year's time, then it would have been possible to settle £5 or 2½ or 1¼ as reasonable share of the creditor. But it is plain truth that the profit of the loan capital is neither fixed nor it can be fixed in this manner. Whether the borrower has gained anything or not is never taken into consideration in determining the market rate of interest? In practice the market rate of interest is determined on entirely different grounds which have no relation whatsoever with reason or justice.

As for the last question: is the actual rate of interest in the world determined according to some rational principles? There are two opinions concerning the determination of the rate of interest in the money market. According to one opinion the rate of interest is determined by the supply and demand for money. If the demand for money is less and the supply of money is excessive, the rate of interest falls. When the fall in the rate of interest is considerable, many people come forward to borrow money for investment. Then gradually, with increase

in the demand for money and fall in the supply of money, the rate of interest rises.

Both the parties speculate about the future gains. The borrower estimates his probable gain from the borrowed money and decides the maximum interest rate he is prepared to pay to the money-lender but it must under no circumstances be higher than the rate of return on capital. Whereas the lender estimates the probable profits of the borrower and fixes the minimum interest rate which he intends to charge on the borrowed capital.

Thus both the lender as well as the borrower are speculating about the probable gains of the latter; the lender always exaggerates the investment gains, while the borrower is always cautious and also conscious of loss. There is a constant struggle instead of co-operation between the two groups. When the borrowers want to invest more funds in the hope of profit, the lenders begin to increase the price of their capital until it becomes unprofitable to invest at the higher rate. As a result, all investment is reduced and the economy is gradually reduced to condition of quasi-slump. As depression spreads the money lenders foresee their own ruin and reduce the interest rate to encourage investment. This gradually leads the economy to quasi-boom conditions. The vicious circle continues to which there is no end. Thus the existing system of lending and borrowing on interest is, to a considerable extent, responsible for the present economic ills of the capitalistic world.

The second group favours the liquidity aspect of capital. When the capitalist wants to keep more liquid funds for his personal use, he raises the rate of interest, and vice versa. Multifarious factors, such as his personal business and speculative motives which are influenced by personal, social, political and economic factors, affect the desire of the capitalist to keep more or less liquid funds. If they increase the desire for liquid funds, the rate of interest rises and checks the flow of capital into investment; on the other hand, if the desire for liquid funds decreases, the rate of interest falls and pushes up the rate of investment.

A cursory glance at the funds held by the capitalist shows that 95% of the liquid funds are used for speculative purposes. He very minutely observes the financial difficulties of society and then releases or withholds his funds from the money market for his personal gains. When he finds that the community needs funds for development or for meeting common danger in the form of famine, earth-quakes, war or similar other emergencies, he increases the rate of interest by withholding funds and thereby makes profit at the cost of society.

In Islam, there is no place for social enemies and parasites and therefore it has prohibited the very institution which breeds such elements in society.

(v) Riba and Trade

Pagan Arabs did not distinguish between Riba and trade and, in fact, considered the former as a form of trade.

They argued that if a person purchased something (e.g., a piece of cloth) for two dinars and sold it for $2\frac{1}{2}$ dinars, it was a fair dealing and quite lawful. Similarly, if a person advanced a loan of 2 dinars and got back $2\frac{1}{2}$ dinars from the borrower, it should also be considered fair and lawful because both the transactions were made with mutual agreement.

The Holy Quran has removed this fallacy by declaring that trade is not like Riba in *Sura Al-Baqara* in the following words:

"They say, trading is only like Riba. And God has allowed trading and forbidden Riba". (2 : 275)

This verse of the Holy Quran has made it quite clear that trade and Riba are not the same thing. Capital invested in commerce, trade and industry, may result in profit which is just and lawful ; but if advance as a loan or deposited in modern banks, it gets an excess in the form of interest which is unjust. Why has God prohibited the latter and allowed the former ? This is because there is a fundamental difference between the two surpluses. The former is the reward for labour while the latter is an unearned income, unrelated to the fruits of labour. Besides, the former stimulates whereas the latter discourages and destroys trade, commerce and industry.

Maulana Abul Ala explains the difference between trade (Bai) and interest (Riba) in these words :

"Bai is a transaction in which the seller offers a commodity for sale to the buyer for some consideration as price, by paying which the buyer takes possession of that commodity or bought it from another person. In either case he charges an additional sum over and above the principal that he invested in producing or procuring the thing as compensation for his own labour which forms his profit".[1]

"Now let us see what Riba is. A man lends capital to another on the condition that after a certain time he would charge a fixed sum in addition to capital. This additional amount, which is interest or Riba, is a payment not for any labour or commodity but for the time for which the principal has been borrowed. Even in Bai if the price of a commodity in changed or dependent on the condition that in the case of nonpayment on the fixed date, it will be increased, this will mean interest or Riba".

"Riba, in essence, is thus an amount charged on the principal as a consideration for the time during which the priacipal is to be used, and it consists of three elements, viz. addition to the principal, the rate of that addition according to time, and the payment of the additional amount being a condition of the bargain. All transactions involving these three elements come under the category of Riba".

Main points of difference between trade and Riba may be summarised as follows :

(*a*) "In trade the capitalist takes the risk of loss along with the hope of profit, but in a money loan the whole of the loss is suffered by the man who uses his labour while the capitalist may count upon profit (i.e., interest) even in the case of loss in the

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1. Quoted by Abdul Majid in Holy Quran, p. 96.

actual concern. Hence trading stands on quite a different footing from usury''.[1]

(*b*) In trade profits are obtained by initiative, hard work and enterprise and are, definitely, the result of a clearcut value-creating process. But this is not the case with Riba which may actually "retard a value-creating or productive process",[2] as will be explained in another section.

(*c*) Another fundamental difference between trade and Riba, as we have explained earlier, is that Riba is a pre-determined surplus over and above the loan conditional to a fixed time; while profits from trade and industry fluctuate and are not pre-determined. This means that Riba, which is pre-fixed, is certain and definite ; whereas profits from trade are neither certain nor definite. In the former there is no relation between the surplus and the effort which acquired it ; while in the latter, there is a direct relationship between the surplus and efforts.[2]

(*d*) A famous scholar Qiffal, while explaining the difference between interest and Riba, says that when a person sells some cloth, which he bought for 10 dinars, to another person for 20 dinars with mutual agreement, the exchange value becomes equal and both the parties to the transaction really benefit. The seller earns a profit of 10 dinars and the buyer receives a piece of cloth which he thinks is of real value to him. Thus the profit of the seller is in exchange for something of real value to him. But if a person receives 20 dinars simply by advancing a loan of 10 dinars for a specified time, then he makes 10 dinars in exchange for nothing. He gave 10 dinars and at the end of the specified time, he received his 10 dinars along with a surplus of 10 dinars in exchange for practically nothing. He cannot claim that this surplus is a reward for time because time is neither a commodity of exchange which can be bought and sold : "nor any such thing which could be pointed out, much less any exchangeable wealth''.[3]

1. Holy Quran translation by Muhammad Ali, pp. 120-121.
2. *Economic of Islam*, op., cit. p. 25.
3. A. Iqbal Qureshi, op. cit., p. 57.

Briefly, it may be said that in all commercial and industrial transactions both the parties give something tangible in exchange ; e.g., the trader gives cloth and the buyer gives money or in bargains of rent, the landlord gives his house on rent while the other party pays money. When the tenant returns the house to the landlord, the house is not the same house but has lost some of its original value in wear and tear. Even though the tenant returns the house intact, it has lost some of its original properties and can never be considered as good as a new house. Thus in these cases both parties to the transaction have made some sacrifice for (or paid something tangible to) the other party. But in case of a loan of money there is no such sacrifice on the part of the capitalist. He receives his money after the expiry of the loan contract, without there being any diminution in its properties. This is because money paid back is exactly equivalent to money advanced as a loan some time ago. Thus the capitalist has lost neitheir his capital nor any of its properties. If he has been receiving monthly or yearly interest for five or ten years on his loan capital, what has he given in return to the debtor ; or what sacrifice has he made for him ? He has received his loan money which has lost none of its qualities or properties. In every commercial or industrial transaction, some kind of sacrifice is made by both the parties but capitalist has made no such sacrifice. He has received regular payments of interest for a specified time and at the end of the term, he has also received his loan capital ; but in exchange he has given no tangible thing to the debtor as it is given in every other transaction (commercial or industrial).

Thus Riba is one way exchange in which one party pays interest and the other party pays nothing for it takes back what it gave at the beginning of the loan contract. In this transaction loan capital is returned to the capitalist and therefore interest is paid not in exchange for any commodity or goods but for time ; on the other hand, in trade the buyer and the seller exchange something real ; the buyer receives goods and the seller receives price money along with the profit for his labour.

Recent fall in the value of money especially in the Western,

World, may create the impression that the creditor does not receive the same amount of loan money in real values. The loan money received after some time has considerably decreased in real value and has, therefore, lost some of its original qualities in terms of purchasing power. The money lent had greater purchasing power than the money received in payment of a loan after some time. The creditor is therefore entitled to a reward for the loss of value in his loan money.

A careful study of the whole problem of inflation and the tremendous rise in the prices would show that it is partly an effect of the interest-governing monetary system and partly due to the manoeuvring and manipulation of the monetary system by certain elements in the economy to suit their own personal selfish ends.

A casual look at the prices of commodities in the 50s and 60s and before the World War II will show that there was very little change either in the value of money or in the prices of commodities and services over a period of time. There was complete stability in the economy. The loan advanced had almost the same real value when returned after a few years.

It is a temporary phase in the economy and is not going to last for ever. It cannot therefore be advanded as an argument in favour of interest. Above all, it is the fruit of our own doing. We are reaping the harvest we have sown. These are some of the evil effects of the unnatural system under which we are living.

(*e*) According to Maulana Maudoodi, the fundamental difference between Riba and trade can be summarised in these words :[1]

1. There is equal distribution of profit in commercial transactions because the buyer benefits from the thing he buys while the seller gets reward for his labour and enterprise in providing that thing to the former. On the other hand, profit is not shared equally between the parties to the transactions containing element of Riba. The capitalist enjoys profit which is always definite and certain ; while the debtor's profit is uncertain ; he may have a profit or a loss in his business.

1. *Interest*, op. cit.

2. In commercial or industrial transactions, however high the profit may be, it is limited and is taken only once ; while in transactions of Riba, the capitalist receives his profit continuously on his loan capital and the amount of profit increases with the increase in time, and, further, there is no limit to this profit. It may actually go far beyond the original loan capital which may never be paid back, even though entire earning and capital of the debtor has been taken over by the capitalist.

3. In trade the bargain ends with the exchange of commodity for the price and the buyer has nothing to return to the seller. But in Riba, after the loan capital has been spent, the debtor has to pay the used up capital back to the capitalist along with surplus in the form of interest.

4. In trade, industry and agriculture one works hard and then receives profit in exchange for one's labour and initiative ; whereas in Riba transactions, the capitalist, merely by giving his surplus wealth, shares in the wealth of other people without any labour of his own. And he then receives his share irrespective of profit or loss and quite unproportionate to the amount of actual profit earned in business.

> "Such are the reasons on account of which God has allowed Bai (trade) and disallowed Riba (interest). There are ethical reasons too, besides these which will be discussed in detail in another section. For example, Riba inculcates niggardliness, selfishness, cruelty, worship of wealth and similar vices. It destroys the spirit of sympathy and mutual help and co-operation. It exhorts people to accumulate wealth and to spend it in their personal interests only. It checks the free circulation of wealth in the community. It creates a channel through which wealth flows from the poor to the rich. The wealth of the community accumulates in the coffers of a selected few which ultimately involves the whole community in economic ruin".[1]

As is well known to the experts in the principles of economic science, all the above effects of Riba are natural. The

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ethical, social and economic system that Islam propounds has no place in it for Riba, which is in conflict with every principle of that system. Even the remotest of the most innocent form of Riba is derogatory to the fair face of that system. That is why the Holy Book of Islam so forcefully declares war against those who give up not what remains of their demand for interest".[1]

1, Quoted by Abdul Majid, Holy Quran, p. 97.

Chapter 6

THE INSTITUTION OF INTEREST IS NOT BENEFICIAL BUT HARMFUL TO SOCIETY

The Holy Quran, while pointing out the difference between trade and Riba, has referred to another fundamental fact that Riba does not increase wealth. In fact, it diminishes wealth by retarding growth of productive process. The Holy Quran refers to this fundamental truth in these words :

(1) "And whatever you give in Riba in order that it may increase on (other) people's property, increases not with God, and whatever you give in charity, seeking the countenance of God, will increase many manifold". (30 : 39)

(2) Again in *Sura Al-Baqara*, it is said :
"God will blot out Riba, and He causes charity to prosper". (2 : 276)

The word 'Mahaqa' signifies firstly that God has taken away (or denied) His blessings or diminished it from all transactions containing the element of Riba : and secondly that God has destroyed or annihilated (the element of growth or prosperity) from al transactions of Riba.

The Holy Prophet also very strongly emphasised that Riba would neither increase national wealth nor it would be conducive to sociall well-being.

The above mentioned verses of the Holy Quran and Hadith of the Holy Prophet point out two aspects of the institution of Riba, namely_:

(*a*) that it does not increase wealth, but instead

(*b*) decreases wealth. In fact, Riba diminishes wealth both materially and morally.

(a) Supporters

This declaration of the Holy Quran is finding supporters even among the Western scholars and some of the economists have begun to look at it with the same eyes.[1] Locke, while quoting from a letter to a friend, says that "high interest decays trade, the advantage from interest is greater than the profit from trade, which makes the rich merchants give over, and put out their stock to interest, and the lesser merchants break".[2] Fortrey affords another example of the stress laid on a low rate of interest as a means of increasing wealth.

According to Sir Josiah Child the real wealth of the kingdom can be augmented by a reduction of the rate of interest.[3] He thought that abatement of interest was the cause of increase of trade and riches of their kingdom. He gave himself much trouble to show that it had been the case in Holland too; and though the Dutch had not at that time any legal restriction on interest, he held that they had made it their policy to keep their rate of interest three or four per cent lower than in other countries.[4] He argues that when merchants have made great wealth, they leave trading and lend out their money on interest, "the gain thereof being so easy, certain and great: whereas in other countries, where interest is at a lower rate the merchants continue trading from generation to generation, and thus enrich themselves and the state".[5]

Sir Thomas Culpepper has taken up the argument that a high rate of interest makes "men grow lazy in their profession, and become usurers...And he further argues that an abatement

1. Khalifa Abdul Hakim, *Islam and Communism* p. 187.
2. Keynes, op. cit., p. 334.
3. Cassel, op. cit., p. 10.
4. *Ibid.*, p. 14.
5. *Ibid.*, p. 10.

of the legal rate will enable improvements in agriculture and revive our dying manufacture".[1]

Although the process by which Riba destroys commerce, trade and industry has become somewhat complicated since the times of Locke, Child and Culpepper, its annihilating effect is as strong and subtle as ever. It is not only high interest, but the very existence of any positive rate of interest, that decays wealth and retards the growth of the productive process.[2]

According to Keynes, the rate of interest, by restricting the level of investment, checks the development of industries which could very well increase the national wealth of the country. And he strongly believes in the doctrine of the old Canonists that the existence of interest is not conducive to economic progress and that it should be checked by legal measures and even by invoking the sanctions of the moral law. To quote him, "There remains an allied, but distinct matter where for centuries, indeed for several millenniums, enlightened opinion held for certain and obvious reasons a doctrine which the Classical school has repudiated as childish, but which deserves rehabilitation and honour. I mean the doctrine of the rate of interest is not self-adjusting at a level best suited to the social advantage but constantly tends to rise too high, so that a wise Government is concerned to curb it by statutes and custom and even by invoking the sanctions of moral law".[3]

Further he maintains that any impediment that destroys the inducement to invest, is a social evil and must be removed. And he insists that rate of interest, if not kept in check, will definitely reduce adequate inducement to invest, and thereby growth of wealth in the community. In Keynes' words :[4] "Provisions against usury are amongst the most ancient economic practices of which we have record. The destruction of the inducement to invest by an excessive Liquidity-Preference was the outstanding evil, the prime impediment to the growth of wealth, in the

1. Cassel, op. cit., p. 13.
2. *Economics of Islam*, op. cit., p. 27.
3. Keynes, op cit., p. 351.
4. *Ibid.*, pp. 351-352.

ancient and medieval worlds. And naturally so, since certain of the risks and hazards of economic life diminish the marginal efficiency of capital whilst others serve to increase the preference for liquidity. In a world, therefore, which no one reckoned to be safe, it was almost inevitable that the rate of interest, unless it was curbed by every instrument at the disposal of society, would rise too high to permit of an adequate inducement to invest".

"I was brought up to believe that this attitude to the rate of interest was inherently absurd, and that the subtle discussions aimed at distinguishing the return on money-loans from the return to active investment were merely jesuitical attempts to find a practical escape from a foolish theory. But I now read these discussions as an honest intellectual effort to keep separate what the Classical theory has inextricably confused together namely the rate of interest and the marginal efficiency of capital. For it now seems clear that the disquisitions of the schoolmen were directed towards the elucidation of a formula which should allow the schedule of the marginal efficiency of capital to be high, whilst using rule and custom and the moral law to keep down the rate of interest".

"Even Adam Smith was extremely moderate in his attitude to the usury laws. For he was well aware that individual savings may be absorbed either by investment or by debts, and that there is no security that they will find an outlet in the former. Further, he favoured a low rate of interest as increasing the chance of savings finding their outlet in new investment rather than in debts".[1]

Silvio Gesell, a German economist, while discussing the doctrine of interest, argues[2] "that it is the rate of interest which sets a limit to the rate of growth of real capital". He therefore recommends a reduction in the rate of interest. He further

1. Keynes, op. cii. p. 352.
2. *Ibid.*, p. 355-357.

adds "that the growth of real capital is held back by the money-rate of interest, and that if this brake were removed the growth of real capital would be, in the modern world, so rapid that a zero money-rate of interest would be justified, not indeed forthwith, but within a comparatively short period of time. Thus the prime necessity is to reduce the money-rate of interest, and this, he pointed out, can be effected by causing money to incur carrying-costs just like other stocks of barren goods. This led him to the famous prescription of "stamped" money, with which his name is chiefly associated and which has received the blessing of Professor Irving Fisher".

The main evils of interest can now be summed up in these words :—

1. The existence of a high rate of interest destroys an adequate inducement to invest, the level of investment falls and, thereby, the level of employment and incomes falls too. As a result of the fall in the amount of aggregate incomes, the amount of aggregate consumption is likely to be adversely affected. And we know that "consumption" is the only object of all economic activity. Therefore any decrease in the level of investment, and hence employment, is bound to diminish the aggregate demand for goods and products of industries and agriculture in the country. In consequence, progress of trade and industry and thereby the growth of capital in the country will be checked.

Keynes, while discussing J. A. Hobson's saving and accumulation of capital, reaffirms the above hypothesis that a high rate of interest, by reducing the amount of aggregate consumption, is likely to retard the growth of capital. And he carries on his argument by saying that[1] "it is the first explicit statement of the fact that capital is brought into existence not by the propensity to save but in response to the demand resulting from actual and prospective consumption. The following quotation indicates the line of thought :

"It should be clear that the capital of a community cannot be advantageously increased without a subsequent increase in consumption of commodities... For every

1. Keynes, op. cit., p. 368.

increase in saving and in capital requires, in order to be effectual, a corresponding increase in immediately future consumption".

Therefore in Keynes' opinion "a relatively weak propensity to consume (resulting indirectly from a high rate of interest) helps to cause unemployment by requiring and not receiving the accompaniment of a compensating volume of new investment, which, even if it may sometimes occur temporarily through errors of optimism, is in general prevented from happening at all by the prospective profit falling below the standard set by the rate of interest".[1]

Thus a high rate of interest, by causing a drop in the level of investment, and consequently, in the level of employment and the amount of aggregate consumption, retards the growth of trade and industry and hence, growth of high rate of interest on trade, commerce, industry and agriculture of a country is very accurately described in the following lines :[2]

> "Economists have justified interest on the assumption that capital is an important agent of production. The justification would have been valid if interest was related to the actual proceeds from the process of production. But interest is not. Capital charges a fixed return irrespective of what the actual income may be. The result is that it weighs down and retards the growth of the productive process. Capital itself is an agent of production. But interest on capital undoes its productivity. Interest, to put it in scientific language, sets a limit to the marginal efficiency of capital. When the marginal efficiency of capital is reduced, it leaves several productive resources unemployed. Two results follow : On the one hand, the limited use of the productive resources reduces the amount of goods produced. On account of the charge of interest, their marginal cost of production rises. So that they have to be sold at a high price, and "on the other hand much

1. Keynes, op. cit. p. 370.
2. *Economics of Islam*, op. cit., pp. 28-30.

labour is left unemployed. So that the economic system based on interest always runs the risk of manufacturers groaning for their "two million shirts unsold" and labourers for their "two million backs uncovered". How much difference would it have made if there were no interest ? The "two million shirts" could have been sold cheaper because of the reduction in their cost of production. On the other side, "the two million labourers" could have found employment if the brake on the marginal efficiency of capital were removed. More purchasing power on the one hand and lower prices on the other would have helped to cover the "two million bare backs" with the "two million shirts" which in interest-ridden economy find no market".

2. "Interest, however, works in a more complex manner to vitiate out economy. For people who have money to save and invest, it provides a liquid form of investment. Their share money is gravitated to banks where they are assured a fixed percentage of interest without taking any part in the production process. The economists have presumed that the money so gravitated would be employed in industry and commerce. But in practice the presumption is rebutted. Quite a substantial part of bank's assets is diverted to unpropductive channels. Banks invest in Government securities, advance money for speculative purposes, and cash bills of exchange. None of these is a productive process. Not even the bills of exchange. Although they facilitate in an ideal economic system (as proposed by the Holy Quran), bills of exchange should be cashed free. Here the point is that the institution of interest provides banks with unproductive channels to employ their capital. So that capital which should have been available for productive purposes becomes scarce. Simultaneously the institution of banks tends to preclude people from investing their money directly in industry and commerce. This produces scarcity of capital available

for productive purposes. The scarcity of capital raises the rate of interest. The increase in the rate of interest only accentuates the vicious influence of interest. More purchasing power diverted to banks ; more bank's assets diverted to liquid and unproductive channels ; a further reduction in the marginal efficiency of capital ; a further limitation of employment ; a further rise in the price of goods ; and lastly a further spectacle of "two million shirts" without market and "two million backs uncovered".[1]

"If there were no interest, the result would be that the purchasing power of the people would be either used in satisfying their desires or invested in industries or commerce, either directly or through banks based on the principle of sharing the actual return from investment. The portion of purchasing power people would spend on their immediate needs would create a demand for goods which would encourage production. The portion they would invest in commerce or industry would provide capital for further productive processes. Either way production would be spurred and employment provided. But the depositor in banks neither invests nor spends. He simply hoards. Banking is really a highly developed form of hoarding. The difference between primitive hoarding and present banking is this : when people buried their store of value under the earth their treasures ran the risk of deterioration and loss. Not so in modern banking. There is no risk in a good bank ; and the value seldom decreases. The second difference is that the depositor in a bank goes on getting interest even though his money may not be employed in any productive process. This advantage was absent in primitive hoarding. The result is that from the social point of view modern banking is worse than primitive hoarding. We never rewarded the hoarders in the past.

1. *Economics of Islam*, op. cit., pp. 28-30.

But we reward the modern depositor with a fixed rate of interest. So that the people who do the most unsocial of works, viz., the depositors and bankers, are the only people who go on amassing wealth. They cause the mass of men to suffer in grinding poverty".[1]

"Here someone may object that the banks do not invest all their resources in unproductive jobs like Government securities, loans for speculative and consumptional purposes and bills of exchange. The answer is that when banks do great long-term industrial toans-although, generally, they are very reluctant to do it—they limit the marginal efficiency of the capital they advance by the interest that they charge on it. We have already seen to what this limitation of marginal efficiency of capital leads : To "two million shirts" without available market and "two million backs" uncovered".[1]

Many Western economists, including Keynes, also believe that interest decays trade and is a hindrance in the growth of wealth. According to Keynes, one of the main causes of the poor resources of the world is the very high liquidity premium attached to money. The high liquidity-premium in the minds of owners of wealth, whether in the form of land, as in the agricultural economies of the past and the present, or in the form of money in recent times, has played an important role in keeping up the rate of interest at too high a level. This tendency, Keynes believes, is mainly responsible for "retarding the growth of wealth from current investment in newly produced capital assets".[2]

In fact[3] "the rate of interest far from providing ample capital, as is popularly believed, acts as a hindrance in the way of the better development of the world". Gasell has very successfully explained this aspect of capital in the following passage. "He argues that the growth of real capital is held back by the

1. *Economics of Islam* op. cit., pp. 28-30.
2. Keynes, op. cit., p. 241.
3. Anwar Iqbal, op. cit., p. 39.

money-rate of interest, and that if this brake were removed the growth of real capital would be, in the modern world, so rapid that a zero money-rate of interest would be justified within a comparatively short period of time. Thus the prime necessity is to reduce the money-rate of interest, and this, he pointed out can be affected by causing money to incur carrying-costs just like other stocks of barren goods. This led him to the famous prescription of "stamped" money, with which his name is chiefly associated and which has received the blessing of Professor I. Fisher".[1]

It may here be pointed out that Islam has imposed very effectively a carrying-cost of approximately $2\frac{1}{2}\%$ in the form of Zakat on all types of stock. This levy of $2\frac{1}{2}\%$ on all forms of stock, as explained in another chapter, is a very effective method of checking any tendency to hoard idle cash balances and, at the same time, is a strong stimulus to invest such idle stocks. People would prefer to invest their cash holdings and thereby make more money than to pay annual levy of $2\frac{1}{2}\%$ and let their cash stocks gradually deplete in course of time. Thus in a Muslim economy, in spite of the non-existence of interest, people would never hoard idle cash balances simply because of a $2\frac{1}{2}\%$ levy in the form of Zakat which they have to pay under all circumstances. They would like to earn more money by investing their funds and pay Zakat of $2\frac{1}{2}\%$ out of their profits.

It is therefore obvious that the Western world is nurturing and defending in the form of interest one of the greatest enemies of mankind. Interest has impoverished humanity by checking the growth of capital and by hindering the development of productive enterprise. Our world would have been more prosperous and the life would have been more comfortable and happier, if the institution of interest had not existed.

If this brake were removed the money-lenders, banks, and all the financial institutions would be compelled to invest their funds in industry and other useful enterprises. All countries would make very rapid industrial progress and the world would

1. Keynes, op. cit., p. 357.

be happier and prosperous.[1]

It must be borne in mind that if the countries of the world, especially under-developed countries "are to develop industrially, the finance must be made to co-operate wholeheartedly on equal basis with industry. It must be on the basis of partnership and not by mere payment of a fixed interest. If the financier is a patner in the industries, his keen business outlook and experience of the management of funds, is likely to stand in good stead and would lead to the better development of these countries. On the other hand, if they are only bondholders, they are likely to take little interest as long as they get their fixed interest".[2]

3. Interest destroys wealth in another way. It assists in bringing economic crises in the capitalist world. It is a state of affairs when goods accumulate for lack of purchasing power and the propensity to consume is low. Production is withheld and credit if contracted which leads to unemployment. Interest plays a predominant part in brining about a crisis. As the boom continues, large sums of borrowed money on interest are invested in productive enterprises, much of which show a satisfactory current yield. Excessive optimism increases demand for loanable funds and, hence, rate of interest. Optimism leads to speculation and further speculation. All this increases the rate of interest; margin of profits narrows but producers in their over-confidence continue producing. Gradually doubts begin to arise "concerning the reliability of the prospective yield as the stock of newly produced durable goods steadily increases. Once doubt begins it spreads rapidly".[2]

Fearing losses, banks raise their rate of interest to very high levels and even try to withdraw the former loans ; thus creating panic in the business world and also increasing unemployment. In these circumstances, buying stops and the market if left with piles of unwanted goods without consumers. Due to high rate of interest, costs soar while the marginal efficiency of capital

1. Anwar Iqbal, op. cit., p. 215.

2. Keynes, op. cit., *General Theory*.

declines as a result of speculative and other ventures, consequently, profits dwindle. The collapse in the marginal efficiency of capital is no doubt fundamental to the problem of crises but a rise in the rate of interest seems to be the core of the whole problem. This is because the rise in the rate of interest is chiefly responsible for the rise in the cost of production which raises doubts about the reliability of the prospective yield. With the fall in the marginal efficiency of capital in comparison with the rise in the cost of production mainly resulting from the rise in the rate of interest, level of investment falls. If there were no interest, marginal efficiency of capital at any level would be profitable and hence there would not be any crises. In fact, it is all due to interest that we find goods without market and needy men without goods. Thus decline in both investment and the propensity to consume in times of crises in the modern world are the offspring of the institution of interest.

4. Interest also destroys national wealth. It is often experienced in capitalist countries that the producers have to destory a large quantity of finished goods or even agricultural produce in order to save the prices from falling below the marginal cost of production. This tremendous loss of national wealth while millions of people are short of food and other requirements for lack of purchasing power, can be avoided by the abolition of interest. This will not only lower the marginal cost of production but will also increase investmeat and thereby purchasing power of the people.

Furthermore, existecne of interest blocks many profitable avenues which could otherwise be tapped. It is a kind of brake which restrains people from employing their capital in many profitable and useful enterprises but with a low marginal efficiency of production. With the abolition of interest, this brake will be lifted and many people will be able to employ their capital in a great many enterprises which they could not do before.

The tyranny of the institution of interest played havoc with trade and industry in by-gone days when production could not

be undertaken or even expanded for lack of capital.[1] "But now in a number of rich countries there is super abundance of savings and large sums of money are simply lying idle.

We find simultaneously with this super-abundance of capital a very large class of unemployed persons. People are unemployed because the capitalists do not find it worth while to invest their funds in the fields where the rate of return is less than the current rate of interest. For instance, if the current rate of interest is 4% and money is invested in irrigation works which directly yield only 3%, then according to the capitalistic view, irrigation is unproductive. The money would not be invested in irrigation work however useful these may be for society. The result is that the capital remains idle on the one hand, the resources remain undeveloped on the other".

"All public works, however, conducive they may be for the benefit of society, remain undone in an interest economy if the yield from such works is less than the current rate of interest. Had there been no pre-determined notion of fixed rate of interest many more useful things would have been done".[1]

Thus it seems almost a proven fact that a high rate of interest (or even any positive rate of interest) retards the growth of the productive process and thereby wealth ; while a low rate of interest stimulates growth of wealth. Hence the institution of interest is not beneficial but harmful to society.

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23. Anwar Iqbal, op. cit., p. 218.

Chapter 7

INTERESTLESS SOCIETY PROSPERS

Our contention is that a community without interest will prosper at a faster rate than that with a rate of interest. Abolition of interest will lay unlimited number of enterprises open to human venture. All those beneficial enterprises, which could not be undertaken before because they did not offer huge profits to the capitalists, would be undertaken in this society. Brakes of interest having lifted, production "would be able to extend in all directions providing employment to millions. Employment would increase purchasing power. Purchasing power would increase demand. Lower price resulting from a decrease in the marginal cost of production would again whip up demand. So that the goods that now can serve no better purpose than being burnt or thrown into the sea will be available for millions who never had the good fortune to use them in their lives."[1] The result of the tremendous increase in investment will be that no profitable and useful avenue will be left untapped.

Thus by increasing the level of investment and by encouraging productive and beneficial, not necessarily profitable, enterprises, it will increase the growth of capital-assets and, at the same time provide employment to millions of people in the country and thereby increase their purchasing power. This, in turn, will provide further stimulus to scores of industries of consumption as well as production goods.

A considerable fall in the rate of interest, not to speak of zero or negative rate of interest, would create unlimited

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1. *Economics of Islam*, op. cit. p. 41.

opportunities of investment in various fields of manufacturing and agricultural industries throughout the world. Cassel seems to be fully conscious of the effect of a substantial fall in the rate of interest on the level of investment but he does not approve this sort of development because he thinks that the conventional rate of interest must be paid under all circumstances.

"The rate of interest", according to Cassel,[1] "has a considerable influence on the yearly rent of houses. It is true that in the case of a house in the city of London, or in the centre of any great town, the ground-rent is by far the most considerable item in the total annual sum paid for the use of the house. But such cases are exceptional, and in general, the interest on the capital invested in the building is the chief item in the house-rent. Supposing, for instance, the rate of interest to be $4\frac{1}{2}\%$ and the total sum of all other yearly expenses to amount to $1\frac{1}{2}\%$ of the capital value of the house, then, if the rate of interest were reduced to $1\frac{1}{2}\%$, the house-rent would be reduced from 6 to 3% of the value of the house. The assumption of the reduction of house-rent to one half is perhaps excessive ; but the reduction of the house-rents in any courtry even to something like one half of the present day figures would undoubtedly call forth an enormous increase in the demand for house accommodation ; for, since this is one of the most intense forms of demand, it has a large capacity for expansion".

"At a very low rate of interest not only would more houses be required, but houses of quite another quality. It would cost but a trifling extra sum in annual rent to build a house of the very best materials ; it is even conceivable that such a house would cost less, the expenses of yearly repair and the instalments on the sinking fund being diminished."[2]

1. Cassel, op. cit., pp. 103-110.

2. Ibid.

"A serious fall in the rate of interest", in the opinion of Cassel, "would have a similar effect on the demand for all commodities or services for which a large quantity of durable instruments is required. There is in all countries, and especially in the thinly populated and under-developed ones, an enormous demand for railways (and similar other enterprises like roads, telephone, telegraph, etc.) which will not pay so long as the rate of interest is 4 or 5% but would pay, and therefore would be built, if the rate of interest went down to something between 1 and 2%. In fact, there is practically unlimited demand for durable goods in general. This is just one of the most essential reasons why the rate of interest remains at its present height : the demand must be restrained within such limits that it can be satisfied by the available supply of working capital. Thus even a slight fall in the rate of interest would create plenty of opportunities for investing capital in durable goods".[1]

This is how Cassel envies the tremendous increase in investment opportunities, resulting from a substantial fall in the rate of interest and suggests restriction on the demand for capital by means of a high rate of interest. He does not realise that restriction on demand for capital would check the growth of industrial development and thereby, reduce the purchasing power of the people. In other words, we would be creating conditions for general unemployment in the country.

Cassel himself admits the tremendous effect of a serious fall in the rate of interest (not to speak of zero rate of interest) on the growth of wealth but heistates to approve it. In his words :

"The chief cost in using very durable goods is at the present time the interest on the capital invested in them. If this principal item were reduced to zero, or even to a small fraction of what it now is, there would be no luxury whatever in the way of substantial and

1. Cassel, op. cit., pp 108-110.

expensive buildings and furniture, or any other durable goods, which people would deny themselves. The pipe-systems for gas and water supply could be extended to every profitable undertaking, not only under the English Channel, but under a great many other water-ways of the world. For the financial burden of the original costs on each year's budget would be practically nil. The readers might add any number of similar instances, even if he confined himself to present technical possibilities. But we should not forget that the entire technical science of our age has been developed under the condition that something must be paid for the use of capital, and that this factor is, therefore, to be strictly economised ; if this condition could be dispensed with, entirely new lines would be opened up for the development of technical processes".[1]

"There would be no luxury which people would deny themselves. Even the most expensive enterprises, unthinkable at present because of their high cost, would be undertaken. All these openings would be made possible by the non-existence of interest ; in other words because the financial burden of the original costs of each year's budget would be practically nil". "It would, however, be useless to consider further the extravagances in which social economy would indulge, if nothing were to be paid for the use of capital. Long before the rate of interest reached the zero point, those needs and desires which require the use of durable goods would have been satisfied out of all proportion, while other wants would have been neglected. Far great a part of the production capacity of society would in this way have been directed towards the manufacture of goods whose use would be, essentially, in the future ; and this could not fail to make the satisfaction of present wants rather meagre."[2]

1. *Cassel*, op. cit. pp. 108-110.
2. *Ibid.*

Cassel seems to be opposed to cheap development and social welfare, resulting from low or zero rate of interest, when he calls this "the extravagences of the social economy". He is so blinded by the dazzling successes of the capitalist system that he can see (or does not like to see) anything else.

Any extension of investment opportunities, owing to the fall in the rate of interest or its abolition, would enable every state to undertake all such beneficial and useful enterprises which could not be undertaken before due to high costs. This would provide employment to millions of people and thereby increase their purchasing power which, in turn, would increase demand. Thus every fall in the rate of interest would be a step forward to prosperity. Abolition of interest would, in fact, increase the growth of capital to such an extent that there would be no luxury which people would deny themselves.

Cassel forgets that human wants are unlimited and insatiable and that there is no limit to human progress. Humanity has suffered so long by the restrictive practices of the traditional monetary systems that it needs a relief which would be most welcome by the down-trodden multitudes all over the world. There is so much to be done in the under-developed and undeveloped countries of the world that it will take quite a long time before even their necessaries of life are satisfied.

There is so much to be done for the welfare of the common man whose standard of living even in the Western countries is far from satisfactory that it will need Herculian efforts to achieve substantial results even after abolition of interest.

The U.S.A. which is considered to be the richest and the most advanced country in the world, has over 35 million (1/6th of the total population) people who have no work and are almost destitute. You can well imagine how much work remains to be done in Western Europe, where the standard of living is far below the Americans, before any one can say that wants of the people have been satisfied out of all proportions as Cassel seems to imagine in his dreamland.

And if you just consider the under-developed and undeveloped countries of Africa, Asia, South America and Eastern

Europe where the overwhelming majority of the people live almost on the verge of starvation, how much human effort is needed and how long will it take before even their bare necessaries of life, not to speak of comforts and luxuries, are satisfied. Even with zero rate of interest it will take some time before anything substantial is achieved in the backward countries of Africa and Asia where overwhelming majority of the people live under sub-human conditions.

Cassel seems to be fully conscious of the unlimited possibilities of development under an interestless society, especially when "we have to do with instruments of greater durability, such as factories, buildings, ships, railways, and waterworks etc."[1] Interest, in such cases, becomes a very important item, and, "as the larger part of the capital used as durable instruments is of this character, the rate of interest has a very material influence on the methods of production. A substantial fall in the rate of interest (not to speak of zero rate) could not but convert a great many technical possibilities into economic advantages, and, sooner or later, into realities ; and there are absolutely no ascertainable limits to the use of waiting in different branches of production, if that waiting were to be had for nothing".

> "Waterworks for different purposes seem particularly capable of absorbing vast amounts of capital, and, as they are in general extremely durable, the price paid for waiting is the all-important item in the cost connected with the use of such works. If, therefore, the rate of interest were nil or nearly nil, such enterprises as the Panama Canal (English Channel Tunnel) would present no financial difficulties. As they would be carried out in such a way as to secure a practically eternal durability, their original cost would be very high ; still, as their use next to nothing, would be a great demand for them, and they could absorb a considerable part of the fresh capital of the world. In almost all countries, plans for canals are being discussed which would admit sea-going vessels to the interior. There can be no doubt that such waterways (and other big enterprises) would be constructed on a large scale, and in a most efficient and expensive manner, if the rate of interest were low (or zero) ; moreover, there would be a tendency to diminish steadily the current expenses of such work by spending more money on the original construction. There are, besides, many other kinds of waterworks, which could prove profitable enough at a very low rate of interest (possibly zero) and would absorb enormous amount of capital. Good instances of such are river-works for the prevention of inundation or for the fertilisation of rainless districts, and the different methods reclaiming land from the sea or from lakes". "One may say that there is always—lying in stock as it were—any amount of technical possibilities in the way of substituting the use of capital for other factors of production. Every fall in the setting free of a part of these possibilities and the conversion of them into actualities".

1. Cassel, op. cit., pp. 121-122.

Thus there seems to be no doubt that a zero rate of interest will offer unlimited opportunities for investment in new enterprises ; even a low rate of interest will open up enormous possibilities of new profitable enterprises.

Almost all the modern economists, including the Keynesian, and post-Keynesian, agree that "a lower rate of interest stimulates an expansion of capital investment in fields which at higher rates would be unprofitable."[1] Professor Von Mises, Hansen and others hold the same opinion that a fall in the rate of interest is favourable to investment.

If a lower rate of interest stimulates investment, a zero rate of interest will provide tremendous stimulus to investment. Numerous enterprises with lower marginal efficiency of capital, which could not be undertaken before because of lower profits,

1. Keynes, op. cit., p. 193.

would be undertaken when the interest falls to a lower level approaching zero. This would naturally increase the level of investment, and, consequently, enrich society. Professor Fisher also believes that the extent to investment in any direction depends on a comparison between the marginal efficiency of capital (which he calls the rate of return over cost) and the rate of interest. In his opinion, to induce investment, "the rate of return over cost must exceed the rate of interest". And "this magnitude (or factor)", according to him, "plays the central role on the investment opportunity side of interest theory".[1]

In a Muslim economy where the rate of interest is zero, the schedule of the marginal efficiency of capital and the state of confidence play a major part in influencing the rate of investment. The Muslim State, as will be explained later, inspires confidence in the current as well as in in the future markets and the chain of rapid inventions keeps up the marginal efficiency of capital, with the consequence, the rate of investment is kept up steady and fairly high to maintain the required rate of growth in the country.[2]

It is our contention that the abolition of interest is absolutely necessary to maintain the level of investment at a speed conducive to social welfare. Human history bears witness to the fact that the investment policy is generally influenced by the profit motive of individuals and it rarely coincides with what is socially advantageous.[3] It is, therefore, necessary to check such a tendendcy in the interest of social good. And in our opinion, the abolition of interest is the best way to stimulate investment for the general good of society. We have no doubt that the zero rate of interest is capable of countinously stimulating the appropriate volume of investment.

Any stimulus desired necessary to maintain the level of investment and the propensity to consume at the required level

1. Keynes, op. cit. p. 141.
2. *Ibid.*, pp. 148-149.
3. *Ibid.*, p. 157.

is supplied by the institution of Zakat and Sadakat. as explained in another Chapter.

Every economy, sooner or later, is likely to reach a point where it becomes unprofitable to extend or undertake new investment without reducing the rate of interest to a very low level approaching zero. This is most likely to be experienced in the modern rich and industrialised countries where the opportunities for investment gradually become scarce. And as the marginal efficiency of capital comes down to the level of the rate of interest, further production of capital-assets is not undertaken.[1] Under these circumstances, it is absolutely necessary to lower the rate of interest (probably to zero) in order to stimulate investment, otherwise the country will be impoverished.

All the misery that follows the phenomenon of the trade cycle in the Western world will be conspicuous by its absence in an interestless society. Fluctuations in the propensity to consume and in the state of liquidity-preference are stabilised at a reasonable level by the institution of Zakat and Sadakat. The expenditure, private as well as public, is kept at a steady pace and the preference for holding idle cash balances is kept in restraint by the payment of $2\frac{1}{2}\%$ of Zakat on all kinds of stocks. These two factors in combination with zero rate of interest protect economy from the effects of a fall in the marginal efficiency of capital but at the same time maintain the rate of investment at a reasonable level.

Even in a capitalist system a lower rate of interest is the most effective method of maintaining a state of boom because a high rate of interest cannot keep full employment in a boom. In the words of Keynes, "Thus the remedy for the boom is not a higher rate of interest but a lower rate of interest. For that may enable the so-called boom to last. The remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi slump ; but abolishing slumps and thus keeping us permanently in a quasi-boom."[2]

1. Keynes, op. cit., p. 228.
2. *Ibid.*, pp. 322-323.

As we suggested earlier, the best and the most effective method of maintaining a reasonably higher level of investment in a country is by encouraging expenditure both in the private and the public sectors through the institution of Zakat and Sadakat and the zero rate of interest. Zero rate of interest helps to maintain an appropriate rate of investment to keep near full employment and the institution of Zakat, assisted by Sadakat, keeps the propensity to consume at a sufficiently high level without increasing liquidity-preference.

Keynes would have greatly appreciated the part played by these two factors in maintaining propensity to consume and, at the same time, the rate of investment at the required level in an economy near full employment. It would be interesting to study his remarks, while discussing U.S. employment and investment during 1923-30, where he says,[1] "New investment during the previous five years had been, indeed, on so enormous a scale in the aggregate that the prospective yield of further addition was, coolly considered, falling rapidly. Correct forecast would have brought down the marginal efficiency of capital to an unprecedentedly low figure ; so that the "boom" could not have continued on a sound basis except with very long-term rate of interest, and an avoidance of misdirected investment in the particular directions which were in danger of being over-exploited. In fact, the rate of interest was high enough to deter new investment except in those particular directions which weer under the influence of speculative excitement and, therefore, in special danger of being over-exploited ; and a rate of interest, high enough to overcome the speculative excitement, would have checked at the same time, every kind of reasonable new investment. Thus an increase in the rate of interest, as a remedy for the state of affairs arising out of a prolonged period of abnormally heavy new investment belongs to the species of remedy which cures disease by killing the patient".[2]

"Furthermore, even if we were to suppose that contemporary booms are apt to be associated with a

1. Keynes, op. cit., p. 323.
2. *Ibid.*, op. cit. p. 324.

momentary condition of full investment or over-investment in the strict sense, it would still be absurd to regard a higher rate of interest as the appropriate remedy ......The remedy would lie in various measures designed to increase the propensity to consume by the redistribution of incomes, or otherwise ; so that a given level of employment would require a smaller volume of current investment to support it."[1]

The institution of Zakat supported by Sadakat very successfully keeps the propensity to consume at an appropriate level by the distribution of incomes among the poorer section of the community and by increasing public expenditure ; while the zero rate of interest helps in maintaining the volume of current investment considered necessary to the existing level of employment.

Thus there seems to be no doubt that the abolition of interest and the restoration of the institution of Zakat and Sadakat will, by stabilising the fluctuations in the propensity to consume, liquidity preferences and the marginal efficiency of capital, maintain conditions of near full employment and an appropriate rate of growth in the economy.

1. Keynes, op. cit., p. 325.

Chapter 8

THE ARGUMENT AGAINST A POSITIVE RATE OF INTEREST

Throughout the past history of mankind, prophets and philosophers have unanimously condemned the institution of interest and declared it unjust. All the famous religions of the world have condemned and forbidden it. Philosophers, such as Plato, Aristotle, the two Catos, Cicero, Seneca and Pautus etc. were strongly against the institution of interest. They believed in the doctrine of the unproductivity of money, which led to the conclusion that interest was unjust.

Plato was of the opinion that the capitalist should neither be given interest nor even the principal of a debt. Gonzales Tellez, while criticising interest remarks that "as money breeds no money, it is contrary to nature to take anything beyond the sum lent, and it may with more propriety be said that it is taken from industry than from money, for money certainly does not breed (by itself) as Aristotle has related."[1] According to Covarruvies, "money brings forth no fruit from itself, nor gives birth to anything. On this account it is inadmissible and unfair to take anything over and above the sum loaned for the use of that sum since this would be not so much taken from money, which brings forth no fruit as from industry of Labour."[2]

Thomas Aquinas while elucidating his arguments against interest remarks that : [3]"there are certain things the use of

1. B. Bawerk, op. cit., p. 13.
2. *Ibid.*, p. 14.
3. *Ibid.*, p. 34.

which consists in the consumption of the articles themselves, and if the use is to be transferred, the article itself must necessarily be transferred with it. Therefore, when an article of this sort is lent, the title to it will always be transferred as well. Now it would be patently unjust if a man should sell grain, and yet, as a separate thing, sell the use the of grain too. In so doing he would either be selling the same article twice, or he would be selling something which does not exist. Exactly in the same way it is unjust for a man to lend things of this sort at interest.

Here also he is asking two prices for one article ; he is demanding that it be replaced by a similar article. That we call interest or usury. Since the use of money, too, consists in consuming or spending it, it is inadmissible in itself, on the same grounds, to ask a price for the use of money".

Aquinas further argues that "Interest is to be regarded as the hypocritical and underhand price asked for the possession common to all, namely time. The usurers claim that time is recognized as the equivalent for which they receive the surplus income which is interest. Thus they sell time which belongs to the borrower just as much as it does to the lender and to all men."[1]

An Italian writer, Misabeau, argues like this, "There is no possible justification for lending out money at interest. In the first place, there is no natural use for money, it is merely a symbol. But to derive a profit from its merely representative character means searching in a mirror for the figure that is reflected there. Nor can the possessors of money avail themselves of the argument that they must live on the proceeds of their money. Their recourse is merely to convert their money into other goods and then gain their living from hiring out those goods (i.e. selling) ! And finally he argues that there is no wear and tear in the case of money (carryingcost in Keynes' words), as there is with houses, furniture and the like. Therefore, a charge for wear and tear would also be unjust."[2]

1. B. Bawerk, op. cit., p. 34.
2. *Ibid.*

The institution of interest was also condemned by the law makers of Rome, Hindu philosophers, the Jews and the Christian priests. The ecclesiastic ban on interest continued until the end of the Middle Ages, so that as late as the 13th century, interest was regarded as unjust. But, gradually, as the influence of church declined, the moral force behind the prohibition of interest weakened and the opposing secular force gained strength, the institution of interest was revived in the European countries and the rest of the world.

Although lending out on interest began to be tolerated, some efforts were made by men of wisdom in England and other Continental countries to keep the rate low and even steps were taken to fix a maximum rate of interest. Famous men like Sir Josiah Child, Sir Thomas Culppeper and Francis Bacon strongly opposed a high rate of interest. It was with weakening of the moral force of the church that the justification of interest gained currency, and once it was permitted it became impossible to control the interest rules.

> "That law cannot keep men from taking more use than you set (the want of money being that alone which regulates its price), if we consider how impossible it is to set a rate upon victuals, in a time of famine ; for money being a universal commodity, and as necessary to trade as food is to life, everybody must have it, at what rate that they can get it ; and unavoidably pay dear, when it is scarce."[1]

This selfish business, like attitude gradually helped to establish the institution of interest as we find it today in our society. As it has been in existence for quite a long time, people think that it is an essential component of modern society and that it is going to stay. But economists and philosophers, who study the problem of interest with an open mind, clearly see its evils and wish that something should be done about it.

Locke stated this view as early as 1621 in a letter to a friend concerning usury, in which he says that "high interest

1. Cassel, op. cit., p. 15.

which consists in the consumption of the articles themselves, and if the use is to be transferred, the article itself must necessarily be transferred with it. Therefore, when an article of this sort is lent, the title to it will always be transferred as well. Now it would be patently unjust if a man should sell grain, and yet, as a separate thing, sell the use the of grain too. In so doing he would either be selling the same article twice, or he would be selling something which does not exist. Exactly in the same way it is unjust for a man to lend things of this sort at interest.

Here also he is asking two prices for one article ; he is demanding that it be replaced by a similar article. That we call interest or usury. Since the use of money, too, consists in consuming or spending it, it is inadmissible in itself, on the same grounds, to ask a price for the use of money".

Aquinas further argues that "Interest is to be regarded as the hypocritical and underhand price asked for the possession common to all, namely time. The usurers claim that time is recognized as the equivalent for which they receive the surplus income which is interest. Thus they sell time which belongs to the borrower just as much as it does to the lender and to all men."[1]

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1. B. Bawerk, op. cit., p. 34.
2. *Ibid.*

The institution of interest was also condemned by the law makers of Rome, Hindu philosophers, the Jews and the Christian priests. The ecclesiastic ban on interest continued until the end of the Middle Ages, so that as late as the 13th century, interest was regarded as unjust. But, gradually, as the influence of church declined, the moral force behind the prohibition of interest weakened and the opposing secular force gained strength, the institution of interest was revived in the European countries and the rest of the world.

Although lending out on interest began to be tolerated, some efforts were made by men of wisdom in England and other Continental countries to keep the rate low and even steps were taken to fix a maximum rate of interest. Famous men like Sir Josiah Child, Sir Thomas Culppeper and Francis Bacon strongly opposed a high rate of interest. It was with weakening of the moral force of the church that the justification of interest gained currency, and once it was permitted it became impossible to control the interest rules.

> "That law cannot keep men from taking more use than you set (the want of money being that alone which regulates its price), if we consider how impossible it is to set a rate upon victuals, in a time of famine ; for money being a universal commodity, and as necessary to trade as food is to life, everybody must have it, at what rate that they can get it ; and unavoidably pay dear, when it is scarce."[1]

This selfish business, like attitude gradually helped to establish the institution of interest as we find it today in our society. As it has been in existence for quite a long time, people think that it is an essential component of modern society and that it is going to stay. But economists and philosophers, who study the problem of interest with an open mind, clearly see its evils and wish that something should be done about it.

Locke stated this view as early as 1621 in a letter to a friend concerning usury, in which he says that "high interest

1. Cassel, op. cit., p. 15.

decays trade. The advantage from interest is greater than the profit from trade, which makes the rich merchants give over, and put out their stock to interest, and the lesser merchants break."[1]

"Adam Smith was extremely moderate in his attitude to the usury laws. For he was well aware that individual savings may be absorbed either by investment or by debts, and that there is no security that they will find an outlet in the former."[2] Keynes repuditates the doctrine of interest as it prevails in the modern world and goes so far as even to invoke the sanctions of the moral law against it.

There is no doubt that interest is an unnecessary and excessive burden on the labouring class of a country and that it gradually diminishes the national wealth by restricting the flow of capital in enterprises with high marginal efficiency of capital, irrespective of their usefulness to the people.

Capitalists are not willing to invest their capital in so many useful enterprises all over the world simply because they are not offered a higher rate of interest. Many useful and beneficial enterprises, which, if undertaken, would greatly increase the national (as well as international) wealth, are neglected because they do not offer higher returns to the capitalists. Thus interest, by applying a brake to the level of investment, is likely to check production and, thereby, growth of capital in a country. Besides, most of the capital is attracted towards the banks which could have been invested in productive enterprises. Therefore, it is most desirable in the interest of social justice and economic development that interest should be abolished.

Some people argue that capital is a factor of production and, like any other factor, is entitled to a reward for its services. We fully agree with this that every factor of production has a right to a fair compensation. We will, therefore, consider the claim of the capitalists for just compensation. In the first

1. Keynes, op. cit., p. 344.
2. *Ibid.*, p. 352.

place, let us examine the question : whether capital is really a factor of production, like labour or organisation ? Obviously, its part in production is very passive and is dependent upon other factors of production. Unless it is used by labour and organisation, it cannot function or assist in production. As such its claim to a share in production cannot be considered on the same grounds as the other factors of production, e.g. as labour or organisation.

Secondly, even if its claim as a factor of production is accepted, its reward must be subject to the same conditions and regulations as those of others. It cannot enjoy special privileges. It cannot claim a fixed share, pre-determined and recurring month after month and year after year, irrespective of the state of business whether gain or loss. If the capitalist claims a share in production like other factors, then it must vary with the variations in profits like those of other shares.

Thirdly, other factors such as labour and organisation do hard work, spend their time and energies in the process of production and then expect their reward for the services they have rendered in production. Even after such a hard work, organisation may not get any reward in case of loss in business. The capitalist, who does not work cannot claim a reward for idleness. Everyone in production has worked for a reward. What about capital ? It expects reward merely for waiting, abstaining or for its imaginary productivity. In an economic system, based on social justice and equity, such an unearned income cannot be guaranteed. It can, however, be granted on the condition that the capitalist is prepared to share in profit and loss of the business.

Then there are many other strong ethical arguments against the institution of interest. It encourages many moral, cultural, social as well as economic evils in society. It inculcates habit of miserliness, selfishness, cruelty, love of money, greed for accumulation of wealth etc., among individuals. It spreads class-struggle and class-hatred among people and checks the growth of ideals of mutual help and co-operation. It prevents free circulation of wealth and, instead, encourages concentration of

wealth in fewer hands which ultimately destroys the social and economic system of a country. Above all, it is basically opposed to Sadakat (charity) which is one of the five pillars of the economic system of Islam. Therefore, Islam forbids practice (i. e. taking or giving) of interest in a Muslim society.

Chapter 9

INSTITUTIONAL FACTORS

A careful study of the doctrine of interest will show that the rate of interest is an institutional and conventional rather than a natural phenomenon in our economic system. The institution of interest exists not because it is something natural or inherent phenomenon of the modern society (or any society) but because it has existed there, for whatever reason, for some time. We maintain the institution of interest because we found it in existence in our society.

The "moderns" freely criticise and condemn the old, and as they say, out-of-date dogmas of religion but they never say a word about interest. They regard the institution of interest as a necessity for modern society because "the entire technical science of our age has been developed under the condition that something must be paid for the use of capital."[1] They, therefore, consider absolutely necessary that the institution of interest must be kept alive at all costs.

A minute observation of the arguments of these people in upholding the conventional components of the economic system will show that their attitude is not very different from those who opposed the teachings of the Prophets in order to maintain the status quo. In fact such people oppose every change which seems to be against their interest. The Holy Qur'an has very clearly described the mentality of these people in the following verses :

(*a*) "When Abraham asked his people as to what do they

1. Cassel, op. cit., p. 109.

worship and that do they (the idols) benefit or harm them ? They said : Nay, we found our fathers doing so'. (26 : 70-74)

(*b*) "In reply to the Prophet Hud, his people said : O Hud, thou hast brought us no clear argument, and we are not going to desert our gods for thy word." (11 : 53)

(*c*) "And to the Prophet Salih his people replied : O Salih, dost thou forbid us to worship what our fathers worshipped ?" (11 : 62).

(*d*) "The Prophet Shuaib received this reply from his people : O Shuaib, does thy prayer enjoin thee that we should forsake that our fathers worshipped ?" (11 : 87)

Whenever any institution or doctrine well established in any society is questioned, the people usually reply in more or less the same way. And interest is no exception. People do not like to abolish it or do without it because they have got used to it as an integral part of their system.

The rate of interest is an institutional and conventional rather than a natural phenomenon in our economic system. Many economists, like Cassel and Proudhon, hold similar views. Cassel was of the opinion that money enjoyed interest because of its special privileged position in comparison with goods. He looked upon money as "veil" and proposed to reduce money to the status of goods by introducing stamped money so that it would not be profitable to hold money and thereby exact interest.

Proudhon also believed that interest was an institutional and conventional nor a natural or physical phenomenon in the system. He proposed an economic order based on competition and private property in which the elements of unearned income-interest and rent—would be eliminated. He proposed to replace the central bank of each country by the people's bank. The basic purpose of the bank was to universalise the bill of exchange and thus overcome the scarcity of money and credit. One of the chief merits of this programme was that it would abolish the preference for money over other forms of wealth, thus making full realisation of the potential productive capacity of the

economy. Under this system unemployment would not exist because there would never be any lack of effective demand. Supply would create its own demand.

Keynes was also of the opinion that high premium attached to money was mainly responsible for many of the ills of capitalist[1] society including a high rate of interest. He maintained that "the world after several millennium of steady individual saving, is so poor as it is in accumulated capital-assets, is to be explained, in my opinion, neither by the improvident propensities of mankind, nor even by the destruction of war, but by the high liquidity-premiums formerly attaching to the ownership of land and now attaching to money."

Further he believed that "the low carrying-costs of money as we know it play quite as large a part as high liquidity-premium in making the money-rate of interest the significant rate. The fact that money has low elasticities of production and substitution and low carrying-costs tends to raise the expectation that money-wages will be relatively stable ; and this expectation enhances money's liquidity-premium and prevents the exceptional correlation between the money-rate of interest and the marginal efficiencies of other assets which might, if it could exist, rob the money-rate of interest of its sting."[2]

In their attitude towards property, Proudhon and Keynes bear an interesting relation to one another. Their position involves a condemnation of all property income, the flow of which is attributed to the artificial scarcity of capital assets caused by the restrictive tendencies resulting from the peculiarities of money. Both writers see in monetary institutions and in the credit structure built upon them the principal cause of economic difficulties.

Cassel is also of the opinion that scarcity of capital is the cause of interest. And obviously scarcity is due to the restrictive practices of the monetary system and other conventional and institutional factors. If this artificial scarcity of capital is some-

1. Keynes, op. cit., p. 242.
2. *Ibid.*, pp. 237-238.

how or other removed, accumulation of capital will soon lower the rate of interest.

Interest, according to Keynes, is only a conventional phenomenon and is mainly influenced by the prevailing opinion as to its future. In his word,[1] "It might be more accurate, perhaps, to say that the rate of interest is a highl y conventional, rather than a highly psychological, phenomenon. For its actual value is largely governed by the prevailing view as to what its value is expected to be. Any level of interest which is accepted with sufficient conviction as likely to be durable will be durable; subject, of course, in a changing societ y to fluctuations for all kinds of reasons round the expected normal."

> "It may, however, be pointed out that because the convention is not rooted in secure knowledge, it will not be always unduly resistant to a modest measure of persistence and consistency of purpose by the monetary authority. Public opinion can be fairly rapidly accustomed to a modest fall in the rate of interest and the conventional expectation of the future may be modified accordingly; thus preparing the way for a further movement......up to a point. The fall in the long-term rate of interest in Great Britain after her departure from the gold standard provides an interesting example of this; the major movements were affected by a series of discontinuous jumps, as the liquidity function of the public, having become accustomed to each successive reduction, became ready to respond to some new incentive in the news or in the policy of the authorities."[2]

Thus, according to Keynes, the rate of interest is purely conventional and, if suitable methods are available, it can be reduced indefinitely. And further because of the institutional factors working against it, a gradual reduction of interest by stages was, in his opinion, the most convenient and effective method.

1. *General Theory*, op. cit., pp. 203-204
2. *Ibid.*,

Keynes also refutes the old conception of interest that it is a price paid to capital because it is scarce. In his opinion this scarcity is artificial and in a properly run society the supply can be increased considerably and the rate of interest reduced to an insignificant level approaching zero. He maintains that "the only reason why an asset offers a prospect of yielding during its life services having an aggregrate value greater than its intitial supply price is because it is scarce; and it is kept scarce because of the competition of the rate of interest on money. If capital becomes less scarce, the excess yield will diminish, without its having become less productive......at least in the physical sense."[1]

According to Keynes, it is not only the scarcity of capital that will not let the rate of interest fall to a lower level but there are other institutional factors which will also keep their pressure in the opposite direction. "It is Keynes belief that theoretical considerations, as well as observations of the past behaviour of interest rates, show that the rate of interest will not fall sufficiently fast or sufficiently far to maintain that level of investment which can ensure full employment. The reason for this belief flows from Keynes defination of interest as a monetary phenomenon. The rate of interest is primarily determined by the quantity of money and by the liquidity preference. And the conditions influencing these two factors can be shown to be unfavourable to a fall in the rate of interest to the extent necessary to ensure a "full employment" rate of investment. Investment will tend to be pushed to the point at which the marginal efficiency of capital and the rate of interest are equal. The long-run tendency would be for investment to increase and for the marginal efficiency of capital to decline. But the "stickiness" of the rate of interest frustrates this tendency and restricts investment. Hence, not only is it theoretically possible that equilibrium will be achieved at less than full employment; the balance of the numerous factors involved is so delicate that the automatic achievement

1. *General Theory*, op. cit., p. 213.

of full employment must be regarded as the less probability.[1]

In other words, so long as the institutional factors involved are freely exerting their influence, the rate of interest will not fall sufficiently fast or sufficiently far to maintain that level of investment which can ensure full employment. As a result, the equilibrium will be achieved at less than full employment, when the rate of interest will be considerably higher than the expected zero rate. If the institutional factors are prohibited from their restrictive practices, equilibrium will be achieved at less than full employment, when the rate of interest will be zero.

Keynes further adds that, "we have seen that capital has to be kept scarce enough in the long-period to have marginal efficiency which is at least equal to the rate of interest for a period equal to the life of the capital, as determined by psychological and institutional conditions. What would this involve for a society which finds itself so well equipped with capital that its marginal efficiency is zero and would be negative with any additional investment ; yet possessing a money system, such that money will "keep" and involve negligible costs of storage and safe custody, with the result that in practice interest cannot be negative ; and, in conditions of full employment, disposed to save."[2]

"If, in such circumstances, we start from a position of full employment, entrepreneurs will necessarily make losses if they continue to offer employment on a scale which will utilize the whole of the existing stock of capital. Hence the stock of capital and the level of employment will have to shrink until the community becomes so impoverished that the aggregate of saving has become zero, the positive saving of some individuals or group being offset by the negative savings of others. Thus for a society such as we have supposed the position of equilibrium, under conditions of laissez-

1. *Eric Roll, op. cit., p. 496.*
2. *General Theory, op. cit., pp. 217-219.*

faire, will be one in which employment is low enough and the standard of life sufficiently miserable to bring savings to zero. More probably there will be a cyclical movement round this equilibrium position. For if there is still room for uncertainty about the future, the marginal efficiency of capital will occasionally rise above zero leading to a "boom", and in the succeeding "slump" the stock of capital may fall for a time below the level which will yield a marginal efficiency of zero in the long run. Assuming correct foresight, the equilibrium stock of capital which will have a marginal efficiency of precisely zero will, of course, be a smaller stock than would correspond to full employment of the available labour ; for it will be the equipment which corresponds to that portion of unemployment which ensures zero saving."[1]

"The only alternative position of equilibrium would be given by a situation in which a stock of capital sufficiently great to have a marginal efficiency of zero also represents an amount of wealth sufficiently great to satiate to the full the aggregate desire on the part of the public to make provision for the future, even with full employment, in circumstances where no bonus is obtainable in the form of interest. It would, however, be an unlikely coincidence that the propensity to save in conditions of full employment should become satisfied just at the point where the stock of capital reaches the level where its marginal efficiency is zero. If, therefore, this more favourable possibility comes to the rescue, it will probably take effect, not just at the point where the rate of interest is vanishing, but at some previous point during the gradual decline of the rate of interest."[2]

"We have assumed so far an institutional factor which

1. *General Theory*, pp. 217-219.
2. *Ibid.*,

prevents the rate of interest from being negative, in the shape of money which has negligible carrying costs. In fact, however, institutional and psychological factors are present which set a limit much above zero to the practicable decline in rate of interest. In particular the costs of bringing borrowers and lenders together and uncertainty as to the future of the rate of interest, which we have examined above, set a lower limit, which in present circumstances may perhaps be as high as 2 or $1\frac{1}{2}\%$ on long term. If this should prove correct, the awkward possibilities of an increasing stock of wealth, in conditions where the rate of interest can fall no further under laissez-faire, may soon be realised in actual experience. Moreover if the minimum level to which it is practicable to bring the rate of interest is appreciably above zero, there is less likelihood of the aggregate desire to accumulate wealth being satiated before the rate of interest has reached its minimum level."[1]

"The post-war experience of Great Britain and the U.S. are, indeed, actual examples of how an accumulation of wealth, so large that its marginal efficiency has fallen more rapidly than the rate of interest can fall in the face of the prevailing institutional and psychological factors, can interfere, in conditions mainly of laissez-faire, with a reasonable level of employment and with the standard of life which the technical condition of production are capable of furnishing."[1]

Keynes, after all this discussion, emphasises the fact that, in the absence of institutional factors and restrictive practices of the monetary authorities, "a properly run community equipped with modern technical resources, of which the population is not increasing rapidly (and even if the population is increasing rapidly), ought to be able to bring down the marginal efficiency of capital in equilibrium approximately to

1. *General Theory*, op. cit., pp. 217-219.

zero within a single generation ; so that we should attain the conditions of a quasi-stationary community where change and progress, would result only from changes in technique, taste, population and institutions, with the products of capital selling at a price proportioned to the labour etc., embodied in them on just the same principles as govern the prices of consumption-goods into which capital charges enter in an insignificant degree."[1]

"If I am right in supposing it to be comparatively easy to make capital-goods so abundant that the marginal efficiency of capital is zero, this may be most sensible way of gradually getting rid of many of the objectional features of capitalism. For a little reflection will show what enormous social changes would result from a gradual disappearance of a rate of return on accumulated wealth. A man would still be free to accumulate his earned income with a view to spending it at a later date. But his accumulation would not grow."[1]

Thus, if the institutional factors are stopped from following their restrictive practices and the prevalent view as to what the value of interest is expected to be is modified by changing the psychological outlook of the people, there will be less difficulty in convincing them that the zero rate of interest was the expected normal rate.

Islam has shattered the influence of the institutional factors and, by its moral education, changed the psychological outlook of the people towards the problem of interest. It has shown them the necessity of lowering the expected normal to zero and has fully convinced them that this normal rate of interest is beneficial to society and is, therefore, going to stay.

1. Keynes, op. cit., pp. 220-221.

Chapter 10

ECONOMIC FACTORS AND THE INTEREST TREND

Most of the economists have completely ignored the important aspect of the problem of interest : why should interest be paid ? They have, instead, attempted to solve another problem : how interest is determined ? We will, therefore, confine our study to the determination of the rate of interest, as discussed by the economists, and will try to prove our hypothesis that the rate of interest will eventually fall to zero. In other words, our contention is that the economic factors, affecting the supply of and demand for capital, as explained by the economists and discussed in another Section, are likely to push the rate of interest down to a very low level approaching zero in course of a few generations.

The problem may be divided into these sentences :

(1) Economists of the 18th and 19th Centuries.

(2) Modern Economists ; and

(3) Secular Trend.

(1) Earlier Economists

Many classical economists, including Adam Smith, Ricardo and J. S. Mill, are of the opinion that the rate of interest has, a tendency to fall with economic progress. Adam Smith believes that the competition among the capitalists lowers the rate of interest. As society progresses and the quantity of stock to be lent at interest increases, the rate, or the price which must be paid for the use of that stock, necessarily

diminishes."[1] Thus, according to A. Smith, there is every possibility that the rate of interest will fall to a very low level, probably approaching zero, when humanity will attain maturity and its rate of accumulation will increase manifold.

Ricardo holds the same views but according to him the principal cause of a decline in the rate of interest is the decrease in the productiveness of capital which results when it is employed on inferior lands to meet the increased requirements of society. "If cultivation were extended," he says, "to lands so unfruitful that the entire product obtained were required for the labourer's subsistence, then interest would fall to zero. But that is impossible because the expectation of gain is the only motive for the accumulation of capital, and this motive becomes weaker as interest diminishes. Hence, even before zero is reached, further accumulation of capital ceases and with it the advance of wealth and of population."[2]

"The competition of capitalists, which A. Smith considers so important, can, according to Ricardo, only temporarily lower the rate of interest, because the increased quantity of capital at first raises wages in conformity with the well-known wage fund theory. But very soon labouring population increases in proportion to the increased demand for labour, and wages tend to sink to the former rate and interest to rise. A permanent reduction of interest is brought about by only one situation. That is the situation which arises when the means of support necessary for the increased population can be obtained only by the cultivation of less productive lands and at increased cost......only from time to time does the tendency of interest to sink with progressive economic development experience check through improvements in agricultural technique, which make it possible to attain the same magnitude

1. A. Smith, *Wealth of Nations*.
2. B. Bawerk, Vol. I, op. cit., p. 61.

of production with less labour than before."[1]

But Ricardo's observations regarding increase in population and the consequent fall in their wages and rise in interest have been proved wrong by our past experience. In fact, population and wages have both steadily risen in the last century and a half; while interest has gradually fallen owing to rapid accumulation of capital.

"Hermann attributes a decline in interest to an increase in the productive power of capital. This places him in direct opposition to Ricardo and his school, who consider the principal cause of a fall in the rate of interest is the decrease in the productiveness of capital which results when it is employed on inferior land."[2]

In short, many of the classical economists agree, though for different reasons, that the rate of interest tends to fall with economic progress.[3] And since the time of Adam Smith, it has become one of the favourite doctrines of economists that as society progresses and capital accumulates, the rate of profit, or more strictly speaking, the rate of interest, tends to fall. The rate will ultimately sink so low, they think that the inducements to further accumulation will cease. This doctrine is in striking agreement with the result of the somewhat abstract analytical investigation given below :

"The interest of capital is the rate of increase of the produce divided by the whole produce ; but this is a quantity which must rapidly approach zero, unless means can be found of continually maintaining the rate of increase. Unless a body moves with a rapidly increasing speed, the space it moves over in any unit of time must ultimately become inconsiderable, as compared with the whole space passed over from the commencement. There is no reason to suppose that industry, generally speaking, is capable of returning

1. B. Bawerk, op. cit., p. 61.
2. *Ibid.*, p. 252.
3. W. S. Jevons, *Theory of Political Economy*, London, 1888.

any such vastly increasing produce from the greater application of capital. Every new machine or other great invention will usually require a fixation of capital for a certain average time, and may be capable of paying interest upon it : but when this average time, is reached, it fails to afford a return to more prolonged investments."[1]

According to this formula the rate of interest must tend to sink towards zero and there are sufficient statistical facts, too, to confirm this conclusion historically. The only question that can arise, and about which later economists have entertained different views, is the actual cause of this tendency. But at this stage we do not intend to indulge in this controversial problem.

(a) French Economists

According to Bastiat, as society progresses.........and Bastiat thinks of it as always progressing......capital continues to occupy a more and more disadvantageous position with regard to labour ; ......the proof that the relative share of capital decreases Bastiat finds in the fact that the rate of interest continues to grow lower as society advances.[2]

Proudhon gave the idea of a surplus-value, arising from the exploitation of labour. Interest, rent and profits he would have abolished. Credit, too, would be granted to every one helping reduce interest to its normal rate, which according to him is nil. All accumulated capital being social property, no one can be its exclusive proprietor. Then the abuse of private property, said Proudhon, consists mainly in the ability to extract income with labour. One of the most important ways in which this is done is through charging of interest on money. If only everybody were able to obtain loans gratuitously no exploitation would take place. Nor would there be any difficulty in establishing workers' syndicates. He regards money as merely a medium of circulation. Following the canonists, he

1. Jevons, op. cit.
2. Haney, H. L., *History of Economic Thought.*

thinks that, like a commodity it ought to be bought and sold at cost, and not lent at interest. Lending at interest enables the owner of money to call one and the same thing several times over without losing his property in it.[1]

Louis Blanc did not believe that interest was legitimate. He thought "time will come when it will no longer be necessary".........For the present at any rate it must be paid, were it only to enable the transition to be made."[2]

Bastiat and Proudhon were of the opinion that if the banks were permitted to issue paper money without full metallic covering, they would be able, to a corresponding degree, to lower their rates of discount, and that under conditions of free competition, that was what they would do. It is in any case easy to imagine a situation in which the credit system is so developed that the bank's necessary holdings of cash and their other expenses are reduced to a minimum. Then according to this view the money rate of interest could fall almost to zero without any increase in the amount of real capital.[3]

(b) American Economists

According to Carey, with progress, societary "circulation" becomes more rapid ; capitalists can demand only lower rates ; wages increase absolutely ; and relatively ; and industrial classes tend toward equality.[4] Interest has been steadily declining and Carey regards this decline in the proportion charged for the use of capital, as the highest proof of man's improved condition...... under which the labourer is rising as compared with the capitalist.

Francis A. Walker was also of the opinion that the rate of interest had a tendency to fall.[5]

(c) German Economists

G. Cassel thinks that a certain amount of waiting (capital)

1. E. Roll, op. cit.
2. Gide and Rist, *A History of Economic Doctrines.*
3. Wicksell, K., *Interest and Prices.*
4. Haney, *Economic Thought*, op. cit.
5. Patterson, S. H., *Readings in the History of Economic Thought.*

is necessary to fill the gap between seed time and harvest...... the longer the period, the greater the amount of waiting. But he seems to think that there is a general tendency in the direction of shortening the period of production. The steadily increasing speed of machinery cannot but accelerate the whole process of production and thereby diminish the quantity of waiting necessary. It is, however, evident that this tendency cannot go much further and we will not be able to meet the increasing demand for capital in this way. This increasing demand for capital can only be satisfied, if there is a very low rate of interest which will, of course, stimulate this increase (in capital) beyond all doubts.[1]

We very often find, among the economists, the idea expressed that interest may, and probably will, sink to a very low rate or even become negative. It is conceivable, we are told, that savings may increase "until the accumulation of capital reaches such a point that interest becomes nominal, or even negative". And it is a common belief that the rate of interest has a natural tendency to fall. It has shown during the past two and a half centuries, a decided tendency to fall and this should, justifiably, strengthen our belief and conclusion that the rate of interest must fall still further until it becomes zero.[1]

In this connection Silvio Gessell went far ahead of his contemporaries and even modern economists.[2] He argues, as explained in another Section, that the growth of real capital is held back by the money-rate of interest, and if this brake were removed the growth of real capital would be, in the modern world, so rapid that a zero money-rate of interest would probably be justified, not indeed forthwith, but within a comparatively short period of time. Thus the prime necessity is to reduce the money-rate of interest, and this, he pointed out, can be affected by causing money to incur carrying-costs just like other stocks of barren goods.

1. Cassel, *op. cit.*
2. *The Natural Economic Order.*

(2) Modern Economists

The rate of interest, according to modern economists, is the price paid for money loans and is determined by factors which may be divided into two groups, those affecting the demand for and those affecting the supply of money. Let us study the factors which affect the demand for and the supply of money.

(a) Demand for Money

Our contention is that, in spite of rapid increase in the demand for money loans resulting from industrial and other developments, expansion of internal and international trade etc., wealth tends to increase faster. In support of our assumption, we would like to examine the factors which affect the demand for money loans.

(i) Economy in the Use of Money Loans

There is a natural tendency to economise the use of durable instruments because of their high costs. Every effort is made to make the fullest possible use of machinery, especially expensive ones in order to avoid unnecessary waste of capital. This is likely to save a considerable amount of capital which can be used elsewhere. In the words of Cassel, "there is a natural tendency to economise waiting just because something must be paid for it. In the case of durable goods, this tendency manifests itself in an effort to get the services out of a durable instrument as soon as possible.........It is possible, however, to wear out machinery and other durable instruments of production in a shorter time by using them more continuously. In this way a considerable amount of unnecessary waiting may be saved. The division of labour, as already pointed out by Rae, has a certain tendency in this direcrion, for, so long as the same labour has to do several different kinds of work, he generally finds it necessary to use many different tools, and most of these must naturally lie idle for the greater part of the time ; whereas, where there is a complete division of labour, the various tools are in a continuous use. Thus waiting is saved."[1]

1. Cassle, op. cit., p. 102.

We have no reason to believe, as some economists do, "that the diminution in the demand for durable goods which might result from this is confined within very narrow limits, and that, so far as division of labour goes, most industries have already reached the limits". Human ingenuity knows no limits and, as such, continuous technical and technological progress in every field of industry is quite feasible.

The problem as how to economise capital through continuous use of the durable goods, has another aspect which has greater practical importaace in our age. A considerable part of the factories, collieries, mines, etc., is not worked more than from eight to ten hours out of the twenty-four. If the work in these factories were continued throughout the whole twenty-four hours on the three-shift system, it would involve a considerable saving in the use of durable instruments and therefore of capital. Such a plan would obviously obtain the same output with a little more than half the number of durable instruments and about one-third or more of the existing factory buildings, machinery and tools etc., would be available for other uses in new enterprises.

> "Such an enormous abundance of capital could, not, however, fail to influence the market in favour of labour and to the disadvantage of the owners of capital. Or, in the terms here adopted, the abundant supply of waiting, in comparison with the demand for it, could not fail to reduce the price of waiting, i.e. the rate of interest."[1]

Thus, in view of this enormous saving in capital through more continuous use of the durable instruments of production, it is likely that the rate of interest would fall.

(ii) Frequency of Employment

This is another factor which has a great bearing on the rate of interest. We have known from experience that "some durable goods, as for instance bridges, are physically capable of yielding an almost unlimited number of services; but the actual use

1. *Cassel, op. cit., 103.*

made of them is often very small, being wholly dependent on the frequency with which they are employed. The principal railway bridges in London (or New York or Paris) are used, at least during some hours of the day, to well-nigh their utmost traffic capacity, but, in the North of Sweden (or in Siberia), there are railway bridges which are not used by more than four or six trains in twenty-four hours. The average use of capital, which attaches to each useful service in these two cases, differs enormously, and is much smaller in the case of an intense traffic of a concentrated population like that of London (or New York or Paris) than it is in districts with a thin and widely spread population. The demand for waiting—as compared with the demand for useful services—must, on this ground, always be relatively smaller in densely populated places. In so far as there is a general tendency for population to increase all over the world, we might expect as the result of this a relative diminution in the demand for waiting."[1]

Thus the fears that with increase in world population the demand for capital will increase at the same rate or even faster than the population are immaterial and imaginary rather than factual.

(iii) Saving of Waste

There is a great waste of capital, like other factors of production, in our society which can easily be avoided with a little care in the process and organisation of production. It is said that, "Under the so called system of Free competition there is, and always must be, in certain branches of production, a tendency to create such a quantity of durable instruments as will meet the very maximum of demand. The upward movement of the market having reached its culmination, the durable instruments of production, the ships, factories, machinery, etc. remain. These instruments, therefore, are very often far in advance of the actual demand. On this peculiar side of our economic life, much light has recently been thrown by the various forms of

1. Cassel, op., cit. p. 104.

We have no reason to believe, as some economists do, "that the diminution in the demand for durable goods which might result from this is confined within very narrow limits, and that, so far as division of labour goes, most industries have already reached the limits". Human ingenuity knows no limits and, as such, continuous technical and technological progress in every field of industry is quite feasible.

The problem as how to economise capital through continuous use of the durable goods, has another aspect which has greater practical importaace in our age. A considerable part of the factories, collieries, mines, etc., is not worked more than from eight to ten hours out of the twenty-four. If the work in these factories were continued throughout the whole twenty-four hours on the three-shift system, it would involve a considerable saving in the use of durable instruments and therefore of capital. Such a plan would obviously obtain the same output with a little more than half the number of durable instruments and about one-third or more of the existing factory buildings, machinery and tools etc., would be available for other uses in new enterprises.

> "Such an enormous abundance of capital could, not, however, fail to influence the market in favour of labour and to the disadvantage of the owners of capital. Or, in the terms here adopted, the abundant supply of waiting, in comparison with the demand for it, could not fail to reduce the price of waiting, i.e. the rate of interest."[1]

Thus, in view of this enormous saving in capital through more continuous use of the durable instruments of production, it is likely that the rate of interest would fall.

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1. Cassel, op., cit. p. 104.

industrial organisation, undertaken in order to avoid the disastrous effects of the tendency just referred to. The Cartels, trust, and other "combines" of industrial enterprises have often been able to dispense with a considerable amount of the durable instruments taken over."[1]

"Hence it is fairly evident that there is great waste of capital traceable to deficiencies in the economic organisation of our present society. There is also a large amount of waste which depends mainly on other circumstaces ; for instance, a great deal of capital is spent on useless and ill-advised experiments. It is, therefore, quite conceivable that we might reach a state of affairs where a much better economy of capital would prevail."[1]

This waste of capital can probably be avoided or at least reduced by a better and more rational organisation of social production and other important sections of the economy and thereby the demand for the use of durable goods and capital can be reduced. And, as there will always be room for improvement and betterment in human organisation, however, perfect they may apparently seem, this effect will continue reducing waste of durable instruments and, consequently, the demand for capital.

(iv) Development of Technical Science

Development of technical and technological science provides ample opportunities of selection between different types of machinery for use in production. And there is a strong tendency towards the substitution of a cheaper and less expensive machinery for more expensive one. This will diminish the demand for durable instruments of production. "This arises from the possibility of attaining the same end by means of durable goods of a less expensive nature ; the substitution of the Marconi system of telegraphy for that by cable being perhaps the most striking instance."[2]

With rapid advances in technical sciences, the scope for

1. Cassel, op. cit., pp. 105-106.
2. *Ibid.*, p. 113.

such progress is likely to be very extensive. And this will not fail to adversely affect the demand for capital and thereby lower the rate of interest.

(v) Concentration of Industry

Now there seems to be a large movement in favour of big "combines" and merger of small industries into huge "giants", especially in the Western countries. This tendency towards "industrial concentration in many cases means better economy in the use of durable instruments. In glove-cutting, a machine is used which does part of the work, the remainder being done by hand labour. One machine can keep 200 labourers at work, but it pays a small employer to use a machine, even if he does employ more than one or two cutters. This is sometimes, done, though it involves of course a great waste of waiting. Thus glovemaking affords an instance of an industry where greater concentration would mean a fall of the demand for the use of durable goods."[1]

Thus economy and frequency of use of durable instruments resulting from the concentration of industry is likely to diminish the demand for capital and, consequently lower the price (interest) of capital. And it is most likely that the recent wave of automation will quicken the pace of "concentration".

(vi) Shortening the Period of Production

There is a definite tendency in modern society in the direction of shortening the period of production. "This tendency is perhaps most prominent in the process of distribution. Modern methods of communication—such facilities e.g. as post, telegraph and telephone—tend to accelerate business operations, while the steady increase in speed of transport shortens the time of actual distribution. There is, besides, in the retail trade a growing tendency to diminish the period of turnover, as consequence of the concentration of this trade in very large shops. But production, even in a more technical sense, is continually being shortened through the extended use of modern means of communication and through the concentration of industry

1. Cassel, op. cit., 115.

into large factories."[1]

"There is, in the best organised industries, very little in the way of materials lying idle between two different acts of production even if these acts have to be carried out in different factories, perhaps at great distances from each other. A modern iron work has no large stock either of raw material or of their product ; yet there is a continuous stream of ore and coal entering, and of iron being turned out of it. This shows that the time which elapses from the movement when coal is found in the earth to that when it is consumed in the production of iron has been shortened to the utmost, the increased reliance now placed upon all kinds of transport arrangements having probably contributed much to these and similar results. A great number of technical improvements have been introduced for the very purpose of shortening the period of production ; and, in nearly all progressive methods, such shortening is more or less incidental. For instance, the steadily increasing speed of machinery cannot but accelerate the whole process of production and thereby diminish the quantity of waiting necessary."[1]

"Again, there are, even in agriculture, some interesting instances of shortening. In Germany (and many other Western countries), the average age of cattle slaughtered is stated to have fallen steadily during the nineteenth century (and the 20th century) ; in the case of sheep, for instance, the decrease is reported to be from eight to ten years in the beginning of the century to two to three years at the end (and still less in the 20th century). This tendency, which probably prevails in other countries as well, implies a very considerable reduction in the period of production of meat. The steadily increasing supply of wheat from the Southern Hemisphere tends, so far as it goes, to diminish the

1. Cassel, op. cit., pp. 125-126.

period of production of bread, reckoning from the moment of harvest, to about one-half."[1]

"It should be observed, finally, that businessmen are becoming more and more accurate in their calculations, and, therefore, more anxious to adopt all schemes for shortening the process of production. An illustration of this is afforded by the well-known fact that houses are now built in a much shorter period of time than was usual only a generation ago, and that, in the most advanced instances, all mechanical appliances are used to accelerate the work, electric light even being supplied to admit of night work".

"In conclusion, we may say that economic development tends to reduce the time spent in production and thereby the total amount of waiting required for it".[2]

This tendency towards shortening the period of production has recently grown stronger in all industries and every effort is now being made to reduce the time spent at every stage in the process of production as well as distribution. Rapidly increasing speed of transport, communication and other mechanical devices is affording every opportunity of accelerating the process of production. And it seems that modern trend towards shortening the period of production will never come to an end.

(b) Supply of Capital

We entirely agree with the common assumption that capital has a natural and necessary tendency to increase faster than the demand for it. And past history of man has shown that, in spite of wars and other political and social disorders, accumulation of capital has been steadily, but surely, increasing faster than the demand for it. We submit the following few facts to prove our point :

(i) Capacity for Saving

According to J. S. Mill, "the amount of net produce, this excess of production above the physical necessaries of the

1. Cassel, op. cit., pp. 126-127.
2. *Ibid.*, p. 128.

producers, is one of the elements that determine the amount of saving. The greater the produce of labour after supporting the labourers, the more there is which can be saved. The same also partly contributes to determine how much will be saved."[1]

In other words, it is the capacity for saving which determines the supply of capital. In the words of Cassel, it is "the surplus of the produce of a society over and above the necessaries which such a society must consume in order to maintain its actual standard of efficiency. So much is, of course, never saved ; still this capacity for saving has a great bearing on its actual volume".[2]

A survey of the last $2\frac{1}{2}$ centuries shows that capital has a natural and necessary tendency to grow faster than the demand for it. Growth of capital, excepting war periods, has been steady and continuous since the early 18th century. And there is no reason to believe that it will not continue to accumulate at the same rate, if not greater, in the future.

(ii) Desire for Saving

It is said that the strength of this desire depends upon the degree of security of life and property. In primitive societies, very little thought was given to the provision for the future mainly because of the extreme insecurity of life and property in those societies. "And security of property as well as life increases, habits of prudence and foresight begin to develop. Some weight is now attached to future needs, and such needs are even provided for, so far as they do not interfere with the more urgent needs of the present. At higher stages of development, more and more distant needs are taken into consideration, and the relative importance attached to them increases".[3]

In view of the great significance (economic as well as social) of this factor, the Holy Qur'an gives top priority of the protection of life and property on its list of commandments. It considers it one of the foremost duties of the faithful to respect and

1. *Principles of Political Economy*, Book I, Ch. XI : 1.
2. Cassel, op. cit., p. 138.
3. *Ibid.*, pp. 139-140.

protect the life and property of every human being in society. The injunction is very clearly stated in the following verse of the Holy Qur'an :

> "O you who believe, eat up not your property among yourselves—nor kill (or destroy) yourselves". (4 : 29)

The Muslim society is, in fact, the custodian of the life and property of all its citizens. And it is regarded as a religious duty of every Muslim to protect the life and property of every member of the community like his own. As a result of this sanctity of life and property in a Muslim society, the people feel safe and secure and think of the future needs and the provision for them. The Holy Prophet emphasised this fact in very strong words in his address to the Muslim Nation at the time of his Last Pilgrimage.

> "In his well known address on the occasion of his last pilgrimage to Mecca, the Holy Prophet enunciated some fundamental principles of an Islamic State. One of them was :
>
> "Most surely, your life, your property and your honour are as sacred as this day of "hajj" (pilgrimage)". This declaration of fundamental human rights binds an Islamic State to scrupulously safeguard the life, property and honour of all its citizens."[1]

Now this general trend in the development of the human mind, as a result of increased security of life and property and higher education, may be regarded as a historical fact, from which it can be very well deduced that "this trend will go on in the same direction "ad infinitum."[2] Cassel thinks that it must slow down very greatly because a rise in the estimation of future needs obviously cannot go beyond a certain limit. But what is that limit, and who is to determine that limit ? Cassel does not answer these questions.

1. Abul 'Ala Maududi, *Islamic Law and Constitution*, p. 287.
2. Cassel, op. cit., p. 140.

The fact is that the people are now more educated; they have more foresight and consideration for the more distant needs; they like to make provision for their old age, for unforeseen circumstances, accidents, education of their children etc. The realisation of all these factors is gradually increasing and is bound to affect (i.e. increase) the supply of capital in future.

It seems very surprising how Cassel arrives at a conclusion which not only is fundamentally opposed to our past experience of $2\frac{1}{2}$ centuries but is quite contrary to the general trend of modern life. He argues like this, "although the progress of civilisation has been marked hitherto by the continuous growth in the desire of providing future needs, it would be wrong to assume that this growth is unlimited."[1]

If there has been hitherto a continuous growth of capital more than the demand for it, there is no reason to believe that it will not continue in the same direction in future.

(iii) Average Length of Human Life

Cassel believes that in general shortness of life has an adverse effect on the supply of capital and, hence, on the rate of interest. In other words, it discourages the growth of capital in the community and thereby raises the rate of interest and vice versa. In his words, "there is, in fact, an intimate connection between the average length of human life and the rate of interest. In a state of war, of internal disorders or general insecurity in regard to life, or in bad climates, the probable length of life is short, and the rate of interest has always, under such circumstances, been high; though other forces have, certainly, contributed to that result, it cannot be doubted that the shortness of life has been an essential factor—In other words, a substantial increase in the average length of life would in all probability be followed by a fall in the rate of interest."[2]

In the last century and a half, there has been substantial increase in the average human life in the Western World. In the

1. Cassel, op. cit., p. 143.
2. *Ibid.*, p. 152.

early 19th century the average life was definitely lower than 30 years but has now gone up to over 60 years. In the U.S.S.R. this standard average age has been attained in the last 50 years. With rapid improvements in medical facilities, diet, working and living conditions and standard of living, the average length of life is steadily increasing all over the world. And if Cassel's hypothesis, that an increase in the average length of life increases the supply of capital and thereby lowers the rate of interest, is correct, then the modern trend of a steady increase in the average life will gradually increase the supply of capital and lower the rate of interest to a very low level, probably approaching zero.

(iv) Rate of Interest and Saving

According to Classical economists, a fall in the rate of interest tends to lower, while a rise tends to raise the supply of capital. But Keynes and most of the modern economists have strongly rejected this view that a high rate of interest is necessary for inducement to save. "The fallacy that a low rate of interest discourages savings has been thoroughly exposed by the experiment of the last war when the U.S.A. was able to save much more at 1% than it ever could during higher rates of interest. The modern economic theory has shown that savings are not determined by the rate of investment, but on the contrary they are determined by the rate of investment. The most commendable and praiseworthy feature of the Islamic Theory is that by abolishing interest it encourages investment to the furthermost possible limit and thus provides adequate safeguard for the accumulation of savings which are the result of investment. In this connection the observation of Keynes are again very interesting for he fully corroborates and conforms to the view put forth by Islam some fourteen centuries ago."[1]

In the opinion of Keynes, "the justification for a moderately high rate of interest has been found in the necessity of providing a sufficient inducement to save. But we have shown that the

1. A. Iqbal, *Islam and Theory of interest*, op. cit., pp. 40-41.

extent of effective saving is necessarily determined by the scale of investment and that the scale of investment is promoted by a low rate of interest, provided that we do not attempt to stimulate it in this way beyond the point which corresponds to full employment. Thus it is to our best advantage to reduce the rate of interest to that point relatively to the schedule of the marginal efficiency of capital at which there is full employment."[1]

Keynes further adds that "interest today rewards no genuine sacrifice. The owner of capital can obtain interest because capital is scarce, just as the owner of land can obtain rent because land is scarce. But whilst there may be intrinsic reasons for the scarcity of land, there are no intrinsic reasons for the scarcity of capital. Any intrinsie reason for such scarcity, in the sense of a genuine sacrifice which could only be called forth by the offer of a reward in the shape of interest, would not exist, in the long run, except in the event of the individual propensity to consume proving to be of such a character that net saving in conditions of full employment comes to an end before capital has become sufficiently abundant (this will not happen in a Muslim state where Zakat will maintain individual as well as social propensity to consume and level of investment at an appropriate level as explained in another section). But even so, it will still be possible for communal saving through the agency of the state to be maintained at a level which will allow the growth of capital up to the point where it ceases to be scarce."[1]

"I see, therefore, the rentier aspect of capitalism as a transitional phase which will disappear when it has done its work—thus we might aim in practice (there being nothing in this which is unattainable) at an increase in the volume of capital until it ceases to be scarce, so that the functionless investor will no longer receive a bonus."[2]

Keynes further stresses his point that a very large proportion of the growth of the capital comes from the savings of the

1. *General Theory*, op. cit., p. 375.
2. *Ibid.*, p. 376.

rich out of their superfluity and is not at all influenced by the rate of interest. Besides, as we have learned from our past experience, the supply of capital coming from the savings of institutions and sinking funds is more than enough to meet our demand in the existing conditions. And he thinks that the growth of capital is more impeded than increased by the abstinence of the rich in the modern times, as is commonly believed. And finally, Keynes adds that "people invest not for income in the way of interest but for speculative gains and capital appreciation. Speculation in productive investments would continue regardless of the interest rate and even through interest was non-existent."[1]

Keynes emphasises that, since the publication of Professor Cassel's Nature and Necessity of Interest, it has been agreed "that it is not certain that the sum saved out of a given income necessarily increases when the rate of interest is increased; whereas no one doubts that the investment demand schedule falls with a rising rate of interest."[2]

After examining scores of tables showing incomes and the rate of interest, Cassel concludes that "we have seen that the fall of the rate of interest, say from 6 to 3% must have weakened the desire of saving in some people, while stimulating it in others. It is, therefore, reasonable to assume that it has had no very considerable effect on the actual accumulation of capital. In a broad sense it might be said that capital is just as willingly supplied at 3% as at 6%."[3]

Pareto, another famous economist, is also of the opinion that saving is not affected by the rate of interest and will continue to increase even if the rate of interest falls to zero.[4]

(v) Conclusion

The demand for capital is undoubtedly increasing with the growth of population, "the spread of civilized wants to all

1. *General Theory*, op. cit., p. 169.
2. *Ibid.*, p. 182.
3. Cassel, op. cit., pp. 155-156.
4. Gide and Rist, op. cit., p. 732.

classes of population, and to all nations, and the higher development of such wants through the progress of science", but there are also forces working in the economy which tend to economise the use of capital through the continuous use and frequency of employment of the durable instrument, better organisation, shortening the period of production, concentration of industry etc.........[1]

The principal tendency on the supply side, on the other hand, is the steady growth of social productivity and the consequent growth of the component of saving. And the overall effect of the growth of social productivity and the desire for saving, in spite of wars, political, social and economic disorders and the rise in demand for capital, has been in the form of continuous growth of capital in our society.

Cassel thinks that "this tendency has its natural limit: it is best characterised as a rising estimation of future needs in comparison with that of present needs, and must therefore necessarily come to a stop when future needs have reached the same level of estimation with present ones."[2]

We do not understand his logic in refuting the long-established historical fact of a remarkable growth of the desire to save without giving any convincing arguments against such a strong tendency. And without showing any precedent, past or present, in support of his views, he insists that we are already near to such a state of things.

But even Cassel, who very strongly supports the opposite view that increasing productivity will be, to a considerable extent, counter-balanced by the greater consumption resulting from the growth of population, is forced to admit the possibility of the growth of the capacity for saving. He says, "that it seems probably that there will for a long time to come, be increase in the capacity for saving."[2]

We can quote leading economists from almost all countries in support of our view that the growth of capital will continue,

1. *Cassel, op. cit., pp. 155-156.*
2. *Ibid.*

in spite of the increase in demand, for a long time to come.

Most of the economists agree that capital will continue to increase rapidly and if the restrictive tendencies and practices resulting from the peculiarities of our present monetary system and international wars are kept under control, it will increase at a much faster rate.

According to F. A. Walker, "despite the urgent and ever-recurring demands for the consumption of wealth in various forms of self-indulgence ; despite the occasional reversal of the course of accumulation in the occurrence of war ; despite all the efforts of mis-governments and social disorders, wealth tends strongly to increase. Since the application of steam power to manufactures and transportation, this rate of increase has been so great as even to transcend the demand for the uses of wealth in undertaking new industrial and commercial enterprises, add thus, with some temporary exception, interest has tended to decline."[1]

Some economists have gone to the length of saying that accumulation of capital will make it necessary not only for the rate of interest to fall to zero but also to pay for its employment just as you pay an agent for farming land in hand, or a caretaker. They argue that, "it is a distinct advantage to those who wish to make future provision to have wealth kept for them until such time as it is most convenient to consume it——and in case of a glut of capital for industrial purposes, it might be necessary to pay for this employment, just as you pay an agent for farming land in hand, or a caretaker for living in an unlet house."[2]

Many economists support the above view. Professor Marshall, in a note to his chapter on "Interest of Capital", points out, "how small a modification of our own world would be required to bring us to another in which the mass of the people are so anxious to provide for old age and for their families after them, and in which the new openings for the

1. Reading, op. cit., p. 668.
2. Foxwell, *Journal of the Institute of Bankers*, 1886.

Napoleonic Wars eclipsed the main trend during the first one and a half decades, the falling rate of interest, visible from the beginning of the century clearly indicated the general trend of this period. The century opened with a rate of interest at 4.92% in 1801 but thereafter the rate steadily declined ; fell to 3.30% in 1824, 3.23% in 1838, 3.12% in 1845 and 3.02% in 1852.

The rate of interest remained steady for about two decades during the early Victorian period but fell in the middle of the seventies and thereafter the downward trend continued till the end of the century when the rate was 2.45%.

(b) France

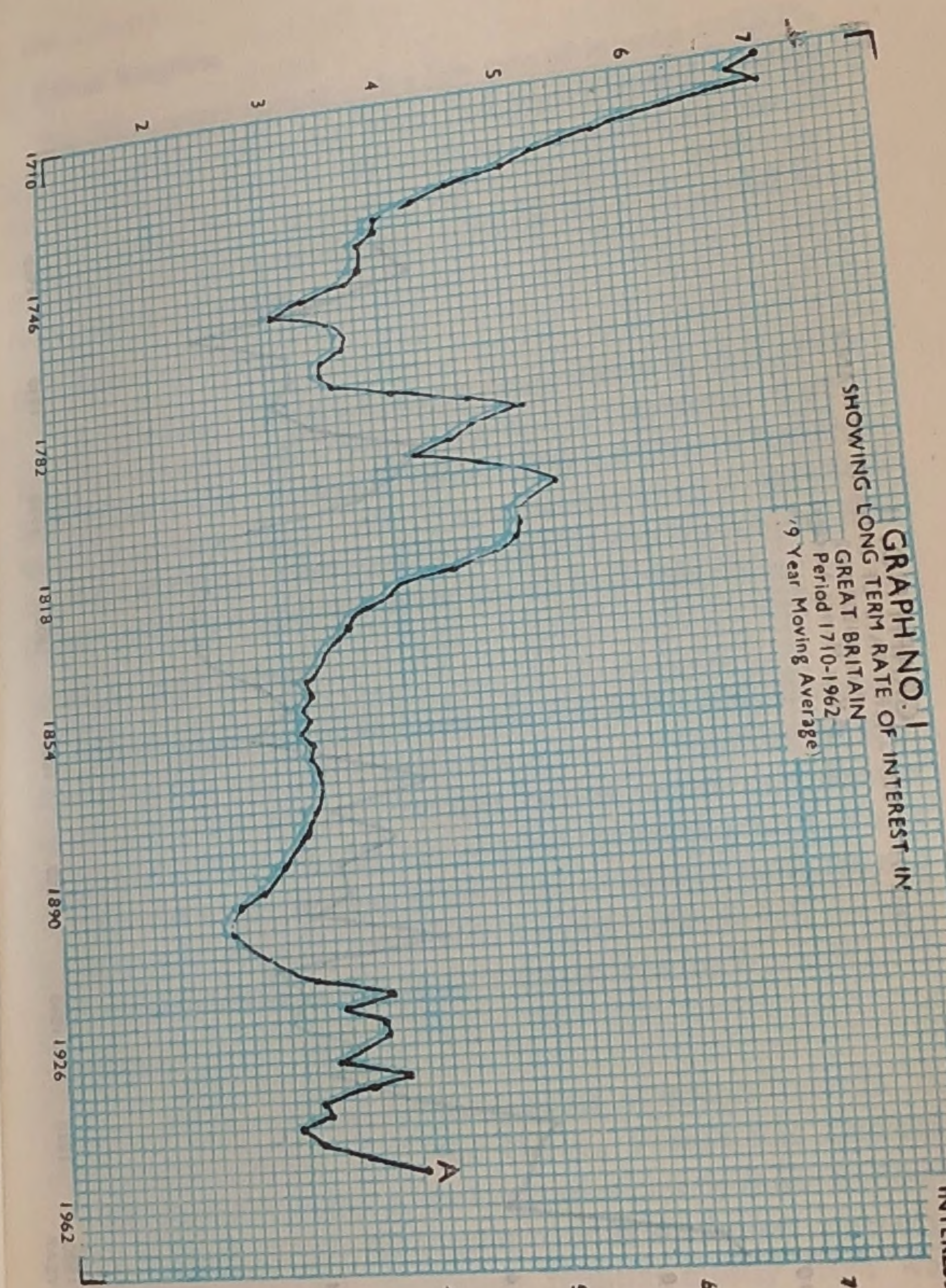
The movement of the rate of interest in France bears a very close resemblance to the trend evident in the U.K. during the 19th century. The level of interest rates in both the countries was high during the Napoleonic Wars but fell thereafter. The 19th century started with a very high rate of interest which stood at 9.3% in 1801 but it steadily fell to 4.40% in 1825 and 3.58% in 1845. During the first two decades of the second half of the century, the rate of interest remained more or less stationary like that of the U.K., but fell in the last two decades and by 1897 it had fallen to 2.91%.

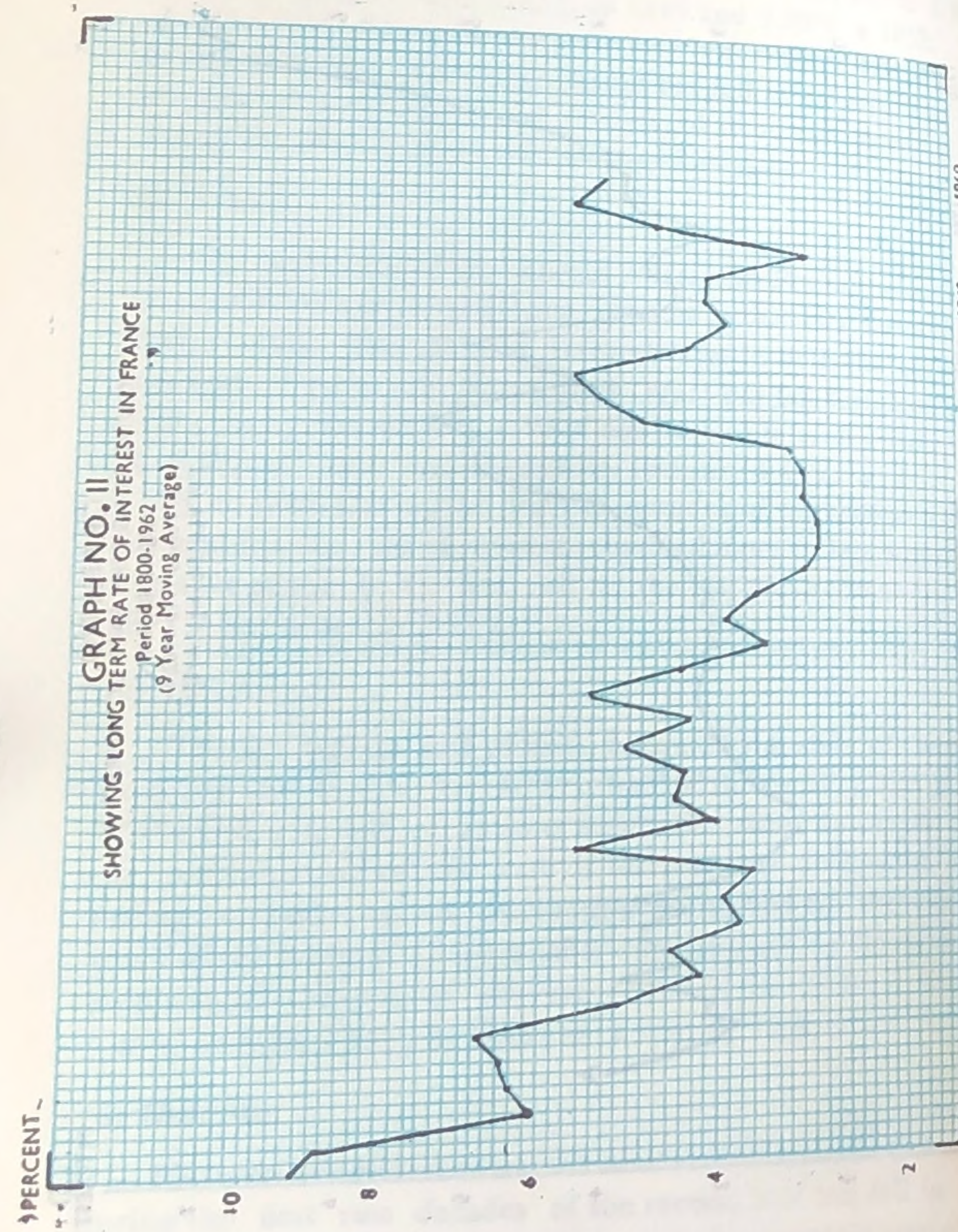
(c) U.S.A.

Though we do not possess adequate statistics of interest rates for the U.S.A. for the first half of the century, the prices of the U.S. 3% and of railway stocks do seem to suggest that the general trend of the rate of interest was downward. The falling trend with minor fluctuations continued till the closing years of the century. The available data of yield on Government bonds show the rate of interest at 6.12% in 1860 ; it fell to 5.46% in 1875, 3.97% in 1885 and 3.54% in 1899.

(d) Germany

The level of interest rates was almost stationary in Germany during the first two decades of the second half but fell in the last quarter of the century. The downward movement started in





1871 when the rate of interest was 4.61% ; it fell to 3.97% in 1881, 3.67% in 1891 and 3.41% in 1898.

3. 20th Century

(a) United Kingdom

The 20th century opened with a low rate of interest at 2.92% in 1901 but owing to clouds of wars, first Boer War and later on the World War I, interest rate began to rise until it was 4.62% in 1919. Thereafter it gradually fell to 4.48% in 1930 and 2.94% in 1936. But again shadow of World War II pushed the rate of interest upwards.

(b) France

The position of France was very much similar to that of the U.K. The century started with a low rate of interest at 2.97% in 1901, but events leading to World War I pushed it upwards until it reached 6.36% in 1925. Thereafter the interest rate fell and maintained the downward trend until it was checked by the preparations for World War II as shown in Graph II.

(c) U. S. and Germany

The trend of the rate of interest in the U.S. and Germany during the first half of the 20th century was very similar to that of the U.K. and France. The rate was low in the early decade of the century in both the countries but the approach of World War I started the upward trend which continued until the end of the second decade. After that the rate began to fall but was checked in the early thirties by the preparations for World War II.

Conclusion

A careful study of the movements of interest rates in the four countries of the U.K., the U.S.A., France and Germany during the last two and a half centuries clearly show a downward trend. Although the secular trend is shadowed and often eclipsed by short-term fluctuation resulting mostly from wars, the downward movement of interest rates is fairly persistent and continuous.

The problem is now what is the explanation of this secular decline in the rate of interest ? Can it be explained by

(a) changes in the Marginal Productivity of Capital, or
(b) the Supply and Demand for Money, or
(c) the Supply and Demand for Loans ?

Let us begin with the first part of the question.

(a) Real Factors

In this section an effort will be made to show how far the available historical evidence is consistent with explanation of secular fall in the rate of interest by real factors (Marginal Productivity of Capital). According to the Marginal Productivity Theorists, the rate of interest is determined by the marginal productivity of capital and, if there is any change in the latter, it is expected to affect the former. In order to find out the causes which might have been responsible for the secular fall in the rate of interest, we must analyse the following two determinants of the marginal productivity of capital.

(*i*) Accumulation of Capital, (*ii*) Improvements in the Technique of Production. Accumulation of capital might have led to the decline in the marginal productivity. Improvements in technique, however, if of a labour saving character, could have the opposite effect.

(b) Liquidity Preference Approach

In this section an effort will be made to show whether the available evidence is consistent with the explanation of secular fall in the rate of interest by the liquidity preference approach.

According to the liquidity preference theory the rate of interest is the "price" which equilibrates the desire to hold wealth in the form of cash with the available quantity of cash. In other words, liquidity preference is a potentiality or functional tendency which fixed the quantity of money which the public will hold when the rate of interest is given. Thus the total quantity of cash which people prefer to hold in relation to the total stock of cash will determine the level of the rate of interest. The larger the quantity of cash people wish to hold, in

relation to the total stock of cash, the higher will be the rate of interest and the smaller the stock of cash which they wish to hold, the lower will be the rate of interest.[1]

The primary purpose why people hold cash is because of (*i*) the transactions-motive, (*ii*) the precautionary-motive, and (*iii*) the speculative-motive. But the crucial variable, which is most likely to affect the cash holdings of people of those times, was the transactions-motive. It consists in the need of cash for current transactions of personal and business exchanges. If the scope of these transactions increases the demand for cash will accordingly increase and vice versa. Thus the strength of this motive which will determine the total demand for cash and hence the level of the rate of interest, depends at any time on the total number of transactions to be performed.[2] Therefore, it is necessary to examine those factors which constituted demand for money at that time.

(c) Loanable Funds Approach

According to the loanable funds theory the level of the rate of interest depends on the demand and supply of loanable funds. If the demand for loanable funds exceeds the supply, the rate of interest will rise, and if, on the other hand, supply is in excess of demand for loanable funds, the rate of interest will fall.[3]

18th Century

The description given by the historians of the wealth and riches of the people and of the conditions of the money market gives the impression that the total quantity of money in circulation was very large during the first half of the 18th century. The stock of cash in the country was further augmented by the influx of gold from India and the Continental countries and by imports of large quantity of foreign coins. And, as the business requirements of the time were not very large, the total demand for cash from transactions-motive was not as large as the existing stock of

1. Keynes, op. cit., pp. 166-168.
2. Keynes, op. cit., p. 170.
3. Robertson, op. cit., p. 3,

cash, with the consequence, the money rate of interest fell. In these circumstances, the people would have invested some of their cash holdings, over and above their transactions-demand in Government securities which must have led to the fall in the bond rate of interest.

Credit expansion of the banks and other credit institutions, which were now overflowing with deposits, could have further eased the situation in the bond market and thereby led to the fall in the rate of interest.

As a result of this fall in the rate of interest, capital must have been diverted to less profitable enterprises, which would have led to the fall in the marginal productivity of capital. Thus we find that the excess of cash in the money market helped not only to lower the money rate of interest but also led to the fall in the bond rate of interest which stimulated investment even in less profitable enterprises and, consequently, lowered the marginal productivity of capital.

The rise in the rate of interest during the second half of the 18th century was mainly due to heavy Government borrowing in the three most expensive wars of the century. The vast growth of National Debt, by increasing the supply of loanable funds, impaired the confidence and good-will of the British Government and thereby lowered the demand and value of securities and thus raised the rate of interest. Besides, increase in the demand for consumption and investment goods, due to high Government expenditure, raised the price level which further reinforced the upward pressure on the rate of interest in the bond market. And, as the wars had increased the business activity, owing to the growth of war industries, the incomes and purchasing power of the people had also increased in the same proportion, resulting in the rise in the demand for cash for transactions-motive and hence rise in the rate of interest.

With the increase in investment opportunities in high-yield wartime industries, the marginal productivity of capital had also risen in those years. As a result, the demand for loanable funds must have greatly increased and, quite likely, diverted capital from fixed-interest securities which appeared less attractive in

comparison with the high-dividend wartime industrial enterprises. And, with the increase in the wartime industrial and commercial activities of the Government, the volume of business transactions must have also increased and led to a rise in the demand for cash from transactions-motive, resulting in the rise in the rate of interest.

19th Century

It seems that the trend of interest rates during the first two decades of the century was influenced more by the French Wars than by any other factor. The pressure of the wars was so great that a very large proportion of British capital was diverted into wartime needs of the Government which almost emptied the Money Market of Great Britain and raised the rate of interest. The enormous strain of war time borrowing must have checked the growth of capital at home and thereby raised its marginal productivity. It is also likely that the demand for cash owing to high cost of living must have increased in relation to the supply of cash which had diminished as result of export of coins and hard cash to pay for war expenses on the Continent. This must have helped to raise the rate of interest during those years.

The end of the Napoleonic Wars released abundant supplies of capital in the British money market for internal development. As soon as the pressure of Government borrowing decreased, increasing amounts of funds were available for private use which increased the supply of loanable funds in the market. The growth of deposit banking and the development of joint-stocks banks also helped in that direction. This abundant supply of funds must have assisted the fall in the rate of interest in the post-war years.

Furthermore, the large supplies of loanable funds in the money market should have encouraged and stimulated enterprises with lower marginal productivity of capital in the years following the Napoleonic Wars. And, as the cost of living was very low, the demand for cash should have fallen substantially, resulting in the decline in the rate of interest.

The fall was arrested in the middle of the forties owing to

great demand for investment in the high-yield commercial and industrial enterprises.

The major factor which seemed to have influenced the movement of the rate of interest during 1850-73 was Government borrowing for war purposes which put heavy strain on the British market. The main reason why the rate of interest did not rise under the great pressure of war demands was that Consols were still valued more as a safe investment than the industrial stocks. As a result, the rate of interest remained almost steady during those years. It also seems likely that the increase in the demand for cash was equally matched by the increase in the supply of money. If, on the one hand, rapid expansion of business transactions had increased the demand for cash, large imports of gold from the new mines in Australia and California, on the other, had greatly increased the supply of money which was evident from the large rise in the bank deposits and circulation of coins in Great Britain.

The influence of the real factors predominated in the early years of 1873-96. With the arrival of peace and slackening of foreign investments, the rate of growth of capital increased faster than in any previous period in Great Britain. The result was a fall in the marginal productivity of capital, leading to a reduced demand for funds for industrial purposes. The fall in industrial profit-margins made Consols more attractive than industrial stocks with declining future prospects.

Besides, the supply of loanable funds in the money market had considerably increased due mainly to the cessation of war-time borrowing and slackening of foreign investments which released enormous supplies of funds for private investment, and to the extensive credit expansion by banks and financial institutions. At the same time, as business was more or less slack relative to the previous or the following years, the demand for cash for transactions-motive declined. The result was a fall in the rate of interest in the last quarter of the 19th century.

20th Century

The rise in the rate of interest in the beginning of the

century was ascribed to the revival of business at home. The years following the Great Depression were characterised by a new wave of confidence and business expansion. The important inventions relating to electricity, chemistry and automobile by increasing the marginal producivity of capital and thereby facilitating the development of iron and steel industries, further stimulated the business expansion in the country. In consequence, the demand for liquid funds substantially increased and led to the rise in the rate of interest. It seems most probably that the expansion of business transactions at home, accompanied by an increased demand for cash, assisted in the upward trend in the rate of interest during those years.

The demand for loanable funds for the South African War (1899-02) and later the Russo-Japanese War (1904—5) maintained pressure in the British money market. Though the demand for funds for foreign investment after 1907 was predominant, the role of armament industries in increasing the pressure was also very significant. During these years the activity in the home market had been kept alive by the ship-building, iron and steel and other industries connected directly or indirectly with armament.

And as more and more of loanable funds were diverted to finance the wars and foreign markets, the growth of capital at home was adversely affected. This must have raised the marginal productivity of capital. The extension of business transations beyond the national barriers on a very large scale must have also increased the demand for cash in general. As a result, the rate of interest went up.

The gap between the two World Wars (1920-1935) witnessed a rapid growth of deposit banking and joint-stock banks in the country. Besides, abundant supplies of capital were released from the World War I, which were now available for private use. Thus increasing amounts of funds, previously blocked by war industries, were now being utilised in industrial and commercial enterprises. The abundant supplies of funds now found floating in the money market must have lowered the rate of interest. This must have further stimulated business enterprise and,

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consequently, lowered the marginal productivity of capital. The low cost of living must have also reduced the demand for cash at that time. In consequence, the rate of interest fell during this period.

After mid-thirties preparation for World War II absorbed huge amounts of British capital. A very large proportion of capital was diverted into war prepartion. This pressur of demand for funds on behalf of the British Government helped to raise the rate of interest. The pressure of war-time borrowing also checked the growth of capital and thereby raised its marginal productivity. The rising cost of living could have further helped in raising the demand for cash. As a result, the rate of interest rose after 1935 and continued rising even after the post-war years.

The Trend in France, Germany and the U.S.A. during the 19th Century

The study of the movements of interest rates in these countries reveals a very close similarity in the trends of interest. The trend was almost identical in the U.K. and France. The level of interest rates in both the countries was very high during the Napoleonic Wars, especially in the latter where it was as high as 8.5%. This high rate of interest was caused by the great pressure of wartime demands on the resources of these countries. As the pressure of war was more axhausting for France, where the actual fighting took place and destroyed the economic structure of the country and the little capital that it had, the rise in the rate of interest was more pronounced than in the U.K. The high level of interest was maintained till the twenties when the cessation of war released large quantities of funds for private investment which helped to lower the rate of interest. The decline in the rate of interest must have pushed capital in less profitable enterprises and consequently, lowered its marginal productivity.

The fall of interest was more marked in France than in the U.K. because of the profound influence of the large supplies of capital which became available after the war. The falling

trend was arrested both in France and the U.K. in the middle of the forties owing to the high-yield enterprises, like railways which raised the marginal productivity of capital.

The main trend of interest, as indicated by the U.S.A. 3% loan and railway stocks, was quite similar to that of France and the U. K. There were, of course, some deviations from the main trend, the first was that the fall of interest in the U.S.A., unlike that of France and the U.K., was continuous from the beginning of the 19th century as there was no extraordinary pressure of war demands which had raised the rate of interest in the latter two countries. Secondly, the rate of interest rose in the U.S.A. during 1835-42 when it was falling in the other two countries. This was primarily due to the great demand for funds for railway building in the U.S.A. The pressure of railway building increased demand for funds in the home market while the capital imports from the Continental countries dwindled almost to an insignificant figure owing to their internal demand for funds for railway building. The consequent excess of demand over supply of funds in the U.S.A. money market raised the rate of interest during 1835-42. But, on the whole, the main trend of interest was nearly similar, particularly so in the case of France and Great Britain, in the first half of the 19th century.

During the scond half of the 19th century the main trend of the rate of interest in almost all the industrial countries, including France, Germany, the U.K. and the U.S.A., was more or less identical. The rate of interest fluctuated within narrow limits and showed no definite trend during 1850-71 ; the average rate of interest was 3.17% during 1851-60 and 3.27% during 1861-70 in the U.K. ; 4.34% and 4.42% in France ; 4.07% and 4.11% in Germany during the same period. The identical movements of interest in these countries were probably owing to somewhat similar conditions affecting the supply and demand for funds.

On the one hand, development of joint-stock banking and the increased supply of gold, from the new gold mines of California and Australia, had greatly helped in adding to

the supply of loanable funds ; while, on the other, the pressure of Government borrowing for war purposes and of railway building, had substantially increased the demand for funds. If the supply of loanable funds had not increased as fast, the rate of interest, under this pressure would have risen very high ; but it remained quite stable for some time because of the equality of forces affecting the demand and supply.

The U.S.A. was not directly involved in the European wars and, therefore, the pressure of demand for loanable funds was not so great in that country. The increasing supplies of capital which were forthcoming from inside and outside the country helped to lower the rate of interest. The fall continued till 1863 when the pressure of Government borrowing in the Civil War led to the rise in the rate of interest.

In the last quarter of the century the main trend of interest in the U.S.A. was in line with that of the European countries. The rate of interest was falling in all these countries; the average rate being 3.17% during 1871-80 and 2.93% during 1818-90 in the U.K. ; 4.59% and 3.65% in France ; 4.24% and 3.79% in Germany and 6.45% and 5.11% in the U.S.A. during the same periods. The pressure of wars had ceased and railway building had slackened which made available enormous quantities of funds for other enterprises. This must have lowered the marginal productivity of capital. Besides, rapid industrial development gradually lowered industrial prices and profits and, consequently made industrial stocks which not only decreassed the demand for funds but also released abundant supplies of unused funds in the money markets of these countries. In consequence, the rate of interest declined.

The Main Trend of Interest in France, Germany and U.S.A. in 20th Century

The 20th century witnessed a remarkable similarity in the main trend of the rate of interest in these countries. The rate of interest steadily rose from the end of the 19th century to the end of the World War I almost in identical manner. Even the short-period fluctuations, resulting from the trade

cycles, were more or less similar, with the exception of minor differences owing to local conditions of each country.

The main factor responsible for the rise in the rate of interest was the extraordinary pressure of war loans (foreign as well as home) which had been pressing the money markets of these countries. This excessive demand for loanable funds raised the rate of interest and slowed down the internal growth of capital accumulation, resulting in the rise in the marginal productivitv of capital. The pressure of foreign demand for funds was probably accompained by rapid expansion of business transactions which must have increased the demand for cash as well.

With cessation of hostilities and gradual return to peaceful conditions, the pressure of Government borrowing eased the money markets of these countries. The supply of loanable funds, previously demanded by war-time industries, was now available for use in private industries. This helped in extending investments even in less profitable enterprises which resulted in the fall in the marginal Productivity of Capital. With the consequence, the rate of interest fell between the two Wars in all these countries.

But as the clouds of World War II darkened the horizon, the pressure of Government borrowing increased very rapidly and pushed the rate of interest upwards. At that time high-yield Government bonds were too attractive in comparison with low-yield industrial stocks, with the result the marginal productivity of capital rose very rapidly. Besides, with increase in war time business transaction and high cost of living, the demand for cash increased considerably. All this led to the rise in the rate of interest.

Concluding Remarks on the Secular Trend of Interest

A study of the secular trend in the interest rates in the U.K., the U.S. A., France and Germany during the last 2½ centuries shows :

1. Firstly that there was a gradual fall in the rate of interest during normal periods of time, undisturbed by war

and other similar events, in these countries. In peace times growth of capital was rapid and faster than the demand for it which helped to lower the rate of interest. On the whole, there was a definite, though slow, downward trend in the rate of interest in the above-mentioned countries during that period.

2. Secondly that the downward trend was halted or reversed only when there was great pressure of Government borrowing for war time requirements. But as soon as the war time pressure for funds eased, enormous supplies of funds were available for investment by private individuals which lowered the rate of interest.

3. Thirdly that the downward trend in the rate of interest, though shadowed by the short-period fluctuations caused by war time Government borrowings, was fairly continuous throughout the period.

The fact that there has been a continuous downward trend in the rate of interest in the U.K. since 1710 can be seen in Graph III on the opposite page.

Curve 'A' shows yield on Consols from 1710 to 1956. The trend is indicated by the line BC. This may be proved by the line of regression which is drawn to estimate the linear predictor of interest since 1710.

Here Y = the rate of interest
X = the year coded

Provisional mean being the middle year 1833.

The line of regression is

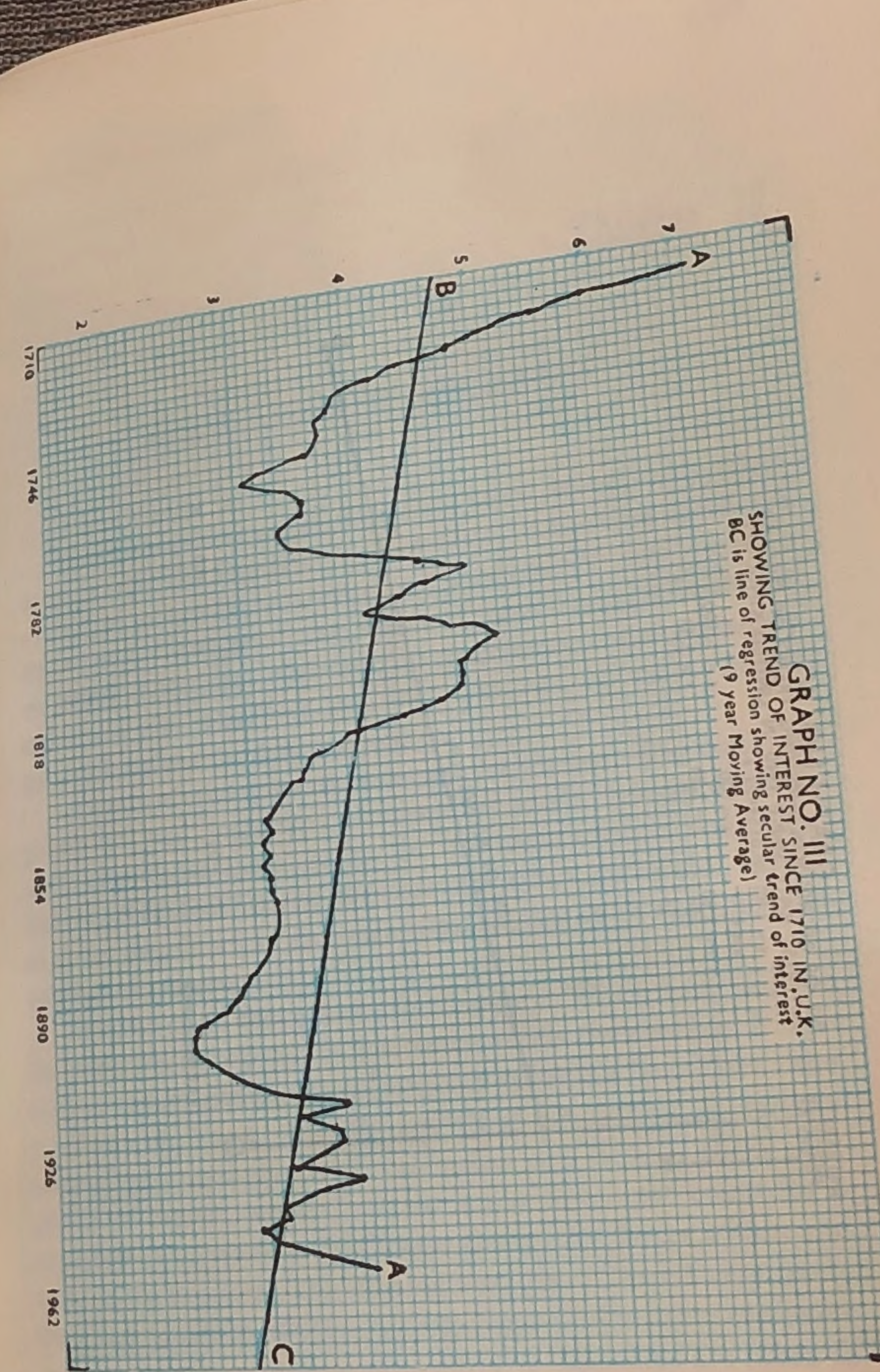
$$Y = 3.80 - 0.0154483\times$$

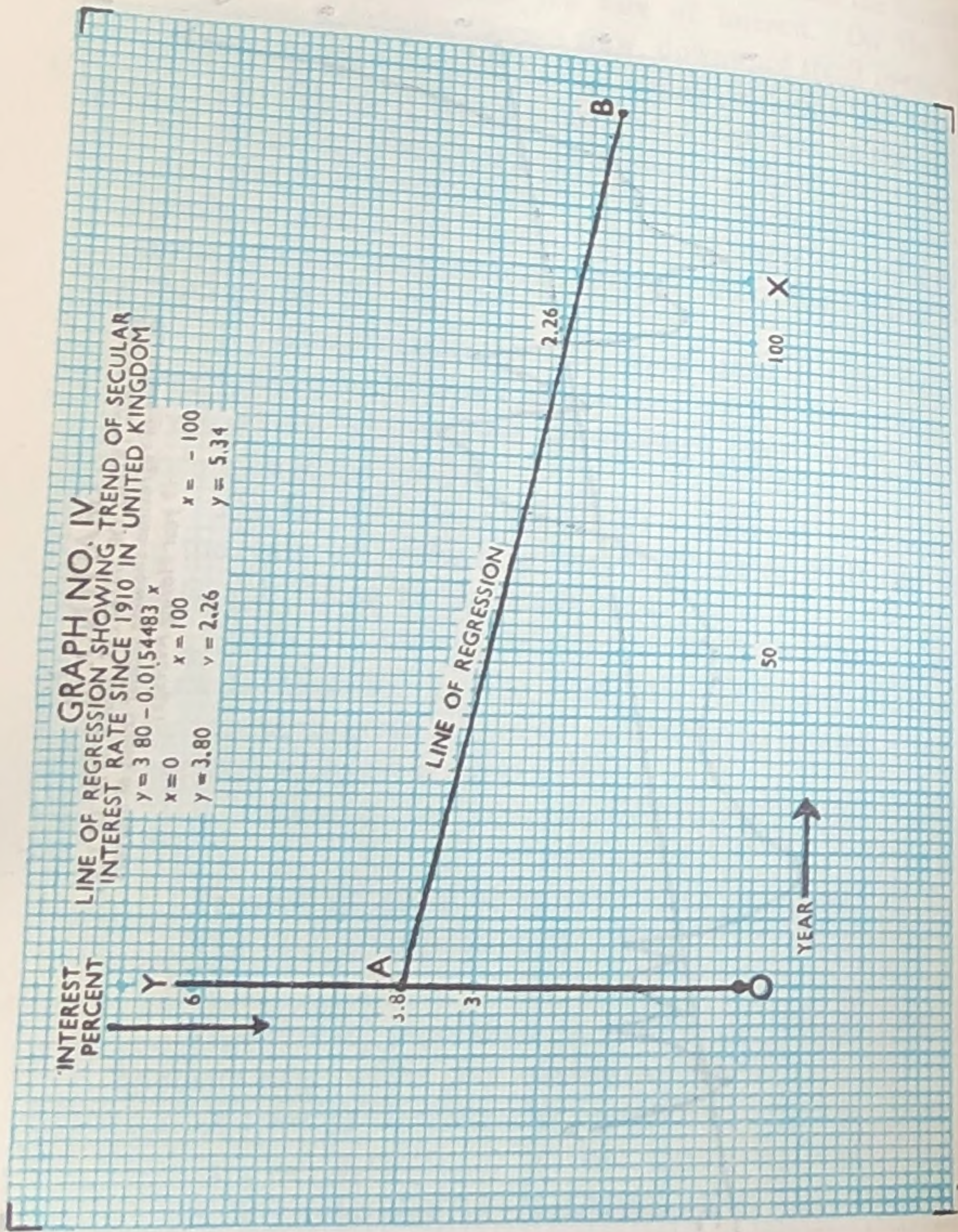
This line of regression is shown in Graph IV on the opposite page where as a convenient point

$X = 0$	$X = 100$	$X = -100$
$Y = 3.80$	$Y = 2.26$	$Y = 5.34$

'A B' is the line of regression which indicates the trend of interest during 1710–1956 as represented by curve 'A' in the Graph on page ?

Similarly it can be proved that the trend of the rate of interest in other countries, such as the U.S.A., France and Germany was also downward during this period.





Chapter 12

ZERO RATE OF INTEREST

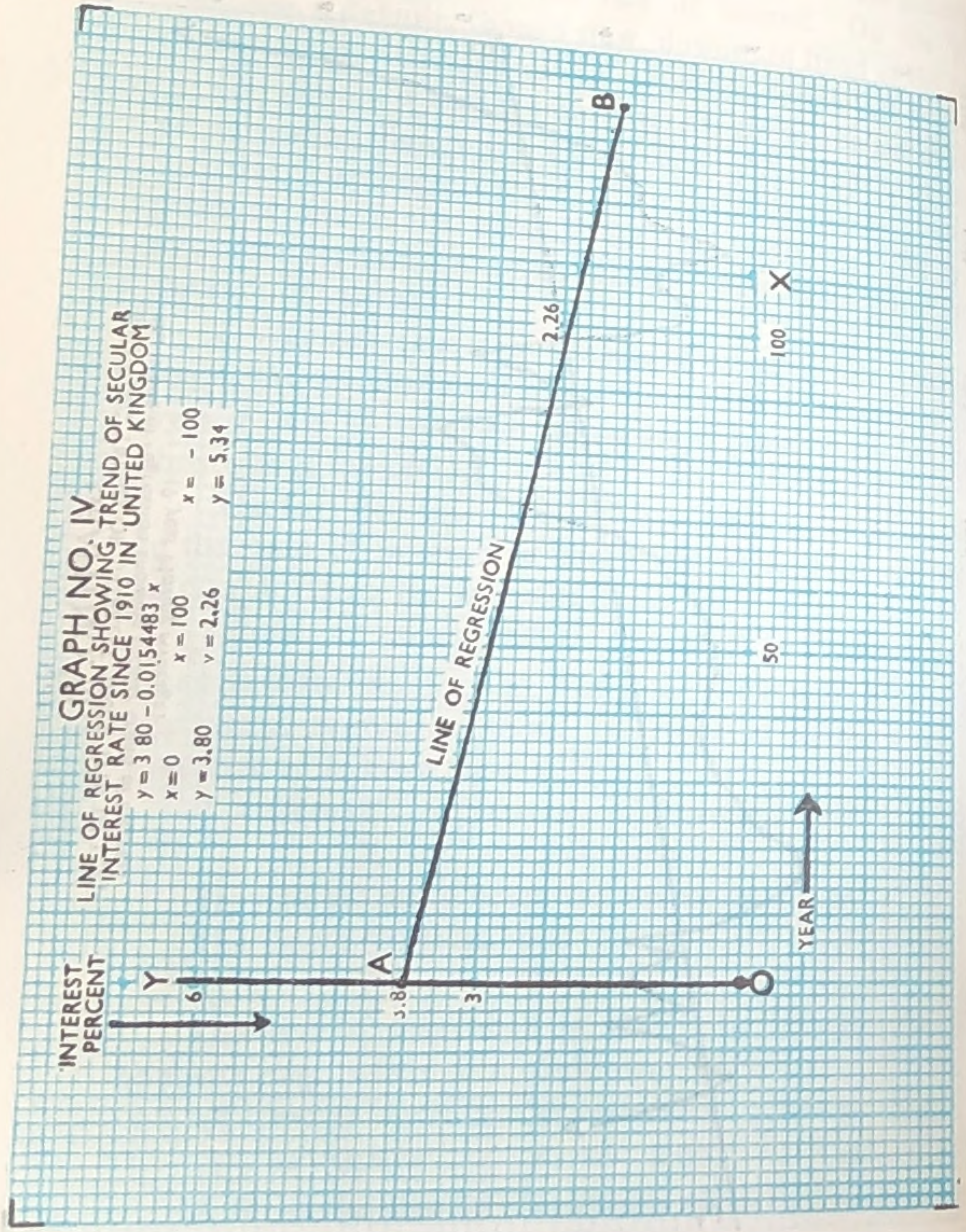
Economic necessity will ultimately force the rate of interest down to zero. The Capitalist economy will in the long run reach a state of economic confusion and chaos which will tend to destroy and disintegrate the whole economic system unless the restrictive and the conventional practices of the monetary authorities are dispensed with and replaced by more liberal policies beneficial to the community.

A study of the present economic trends such as growth of population and increasing demand for goods, unemployment, under-employment equilibrium in the industrialised countries, lack of productivity in the under-developed countries etc., makes us doubt the efficacy of the measures suggested by the Classical and Western economists.

In spite of all the efforts, the Western World have not so far succeeded in solving its problems within the existing framework of the system. Demand for goods resulting from rise in the standard of living and the growth of population is rapidly increasing: unemployment and prices are steadily rising but growth of capital, especially in the under-developed countries is very slow; as a result multi-farious destructive forces within and without the economy are gaining strength. It seems very likely that these problems will gain momentum and become explosive in a few generations unless some effective measures are taken to strike a balance between the opposing forces in the economy.

(a) Growth of Population

So long as population (and the standard of living) goes on



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(a) Growth of Population

So long as population (and the standard of living) goes on

increasing, the demand for consumption and production goods will continue rising. The demand for useful services, such as roads, railways, bridges, water and electric supply and similar other utility projects will certainly increase even in the most industrialised countries of the world.

This tremendous increase in the demand for useful and advantageous services could never be satisfied at the prevailing rate of interest. It is, therefore, likely that the social pressure for the acquisition of multifarious services, advantageous to society but not very profitable owing to their low marginal productivity, will break down the conventional institutional barriers and force the rate of interest down to a level approaching zero at which the level of investment will be sufficiently high to satisfy the increasing demand.

(b) Under-developed Countries

With the spread of civilised wants to all classes and to all nations, the demand for goods will further increase. Backward and under-developed countries of Africa, Asia and South America will gradually develop and industrialise on, more or less, the same pattern as the West. This will create further demand for more public utility services and other advantageous projects in these countries. The development schemes and other technical possibilities in these countries will never be realised unless the rate of interest is substantially reduced to make them profitable. Time will prove that the force of public demand for essential services and utility projects is much greater than the so-called conventional and restrictive monetary practices which keep the rate of interest high.

These restrictive practices will, in the end, yield to the pressure of social services and interest will, therefore, be forced down to the level at which the rate of investment will lead to a minimization of social welfare.

There are innumerable socially advantageous enterprises which are not being undertaken at present because of their lower marginal productivity in relation to the prevailing rate of interest. Among other useful new enterprises are de-salting sea-

water and the control of nuclear fusion which offer an inexhaustible source of irrigation and energy respectively. How long the conventional practices are going to block the progress of humanity, it is very hard to tell. But this cannot go on for ever. Social pressure is bound to bear fruit in the long run when these projects will become practical possibilities owing to fall in the rate of interest.

(c) Problem of Unemployment

Though the problem at present is not very serious in the industrialised countries of the West, with more automation and increasing use of labour-saving machinery, when millions of labourers will be rendered unemployed, it is bound to become very actue. The problem is already becoming serious in some of Western countries and within one or two generations, it is likely to become one of the most acute problems in the Western world. And as the Western type of industrialisation is spreading to the Eastern and African states, they will face the same situation a few generations later. As a result, capitalist society will be faced with a very grave situation, which will be the outstanding fault of the economic system in which we live.[1]

The most effective method of solving the problem of under-employment equilibrium is to stimulate investment so that many more new enterprises are undertaken to provide sufficient work for the idle population of the country. But this can only be made possible if the rate of interest is substantially reduced to a very low level approximating zero, in order to enable new projects with lower marginal productivity to be undertaken. And it is most probable that the monetary authorities, finding no other way out of this situation, will be forced in the interest of the social good to reduce the rate of interest.

Keynes very emphatically supports the view that a substantial reduction in the rate of interest is necessary to ensure full employment, even if this substantial reduction may mean an interest rate approaching zero. It is undoubtedly true that when

1. Keynes, op. cit., p. 372.

the problem of unemployment becomes very acute ; the industrialists suffer heavy losses ; huge stocks remain unsold for lack of demand ; millions of people go without food and clothing and profitable enterprises seem scarce ; the only effective measure to boost investment and the propensity to consume, under these circumstances, is a considerable reduction in the rate of interest.

Keynes argues that if full employment requires a rate of interest much below the average current rate, then do away with the conventional rate of interest and let the economy manage itself without it. The welfare of society is the first consideration; if social interest and public good is in abolishing the time-honoured institution of interest, then it must not be allowed to survive any more."[1]

1. *General Theory*, op. cit., pp. 308-309.

Chapter 13

POSSIBILITYS OF A ZERO RATE OF INTEREST

In view of our above discussion, we may say that the rate of interest will fall to zero in the not very distant future and that society will get rid of this unsocial institution for the general good of people. In this connection, we will first discuss Keynes' views and then Islamic conception of zero rate of interest.

Keynes stongly advocates direct state control over some of the economic variables which affect the general good of society. He is of the view that, to ensure full employment, the state, which is in a position to calculate the marginal efficiency of capital-goods on the basis of the general social advantage, should take an even greater responsibility for directly organising investment,[1] controlling the rate of interest and the propensity to consume.[2] He believes that this is the only effective way to maintain full employment in a capitalist economy.

In order to achieve the full employment, he recommends a limited central control on investment.

(a) Social Advantage :

Keynes thinks that the investment policy which is socially advantageous rarely coincides with that which is most profitable. People desire to see quick results and make quick money.[3] They want to become millionaires

1. *General Theory*, op. cit., p. 164.
2. *Ibid.*, p. 219.
3. *Ibid.*, p. 157.

in a short time and are often prepared to sacrifice any social or national good to achieve their personal ends. It is, therefore, absolutely necessary that the state should take greater responsibility for directly organising investment in order to protect the community from reckless and selfish profiteeers.

(b) Full Employment :

Keynes firmly believes that full employment cannot be attained and maintained by a higher rate of interest and low propensity of consume. This can only be achieved by a considerable fall in the rate of interest[1] which, he says, is not possible because our long experience shows that it usually rises too high to permit of an adequate inducement to investment.[2]

He thinks that the only means to bring an adjustment between the propensity to consume and the inducement to invest is through State control. The State should exercise a guiding influence on the propensity to consume by redistribution of income partly through its scheme of taxation, partly by fixing the rate cf interest and partly, perhaps, in other ways.[3]

This scheme, he believes, will allow "the intelligence and determination and execution skill of the financier, the entrepreneur to be harnessed to the service of the community on reasonable terms of reward."[4]

He emphasises that unless the rate of interest and the rate of investment are not deliberately controlled in the social interest and are mainly left to the influences of laissez faire, the level of employment in the community is bound to fall.[5]

In order to maintain a reasonable rate of investment which corresponds to full employment, a very low rate of interest is required. But this is not possible because "institutional

1. *General Theory, op. cit., p. 376.*
2. *Ibid., p. 351.*
3. *Ibid., p. 372.*
4. *Ibid., pp. 376-377.*
5. *Ibid., p. 219.*

and psychological factors set a limit much above zero to the practicable decline in the rate of interest".[1] The State must therefore, deliberately control the rate of interest and the rate of investment.

Keynes argues that by these methods, the State cannot only achieve its goal of full employment but can, at the same time, save the community from complete destruction."[2] In his words :

> "I defend it both as the only practicable means of avoiding the destruction of economic forms in their entirety and as the condition of the successful functioning of individual initiative———. It is certain that the world will not much longer tolerate the unemployment which is associated—and, in my opinion, inevitably associated—with present day capitalistic individualism. But it may be possible by a right analysis of the problem to cure the disease whilst preserving efficiency and freedom."[3]

He is prepared to go to any length, even to invoke the force of custom and moral law, to bring down the rate of interest".[4]

Keynes also thinks that the current volume of investment cannot be safely left in private hands owing to the regular occurrence of trade cycles in a capitalist society.[5]

Society needs protection from the grave consequences of booms followed by slumps and leading to wide fluctuations in the marginal efficiency of capital and the level of employment. He, therefore, suggests State control of investment and the rate of interest as a safeguard against the harmful effects of post-boom periods. By these means, he argues, such conditions can be created in an economy which will make the boom or partial boom to last permanently.

1. *General Theory*, op. cit., p. 218.
2. *Ibid.*, p. 379.
3. *Ibid.*, p. 380-381.
4. *Ibid.*, p. 352.
5. *Ibid.*, p. 320.

He thinks that the State control may be the most sensible way of getting rid of many of the objectionable features of capitalism :

"For a little reflection will show what enormous social changes would result from a gradual disappearance of a rate of return on accumulated wealth. A man would still be free to accumulate his earned income with a view to spending it at a later date. But his accumulation would not grow———. Though the rentier would disappear, there would still be room, nevertheless, for enterprise and skill in the estimation of prospective yields about which opinions would differ".[1]

Thus Keynes is a very strong advocate of State control of the rate of interest and investment for the general welfare of society. He thinks that such a policy can easily prove successful in maintaining a zero or even a negative rate of interest if it appeals to public opinion as being reasonable and practicable and in the public interest. If the people are strongly convinced that the State has taken the right decision for the welfare of the public and that is going to stay, such a decision, Keynes believes, will stay.[2]

He believes that "public opinion can be fairly rapidly accustomed to a modest fall in the rate of inertest and even the conventional expectation of the future fall in the interest rate can be modified accordingly ; thus preparing the way for further fall in the rate of interest. The fall in the long-term rate of interest in the U.K. after departure from the Gold Standard provides a very good example of this ; ———— During this period the major movements were affected by a series of discontinuous jumps, as the liquidity function of the public, having become accustomed to each successive reduction became ready to respond to some new incentive in the views or in the policy of the authorities.[3]

1. *General Theory*, op. cit., p. 221.
2. *Ibid.*, p. 203.
3. *Ibid.*, p. 204.

To sum up, Keynes believes that if the State action enters as a balancing factor in the economy to provide a reasonable growth of capital without being undue burden on the standard of living of the present generation, then a properly run community should "be able to bring down the marginal efficiency of capital in equilibrium approximately to zero within a single generation".[1]

Islamic Conception of Interest

An Islamic State stands between the two extremes of capitalism and socialism. It leaves the economy neither in the control of a few capitalists in whose hands "enterprise becomes the bubble on a whirlpool of speculation",[2] nor does it allow proletarian (communistic) regimentation to destroy individual initiative, freedom and efficiency. It safeguards the welfare of the community against the capitalists and protects it from the harmful effects of trade cycles, which result in depressions and unemployment.

There is no denying the fact that the State intervention and control becomes absolutely essential, in certain circumstances, to protect the economy from complete destruction and annihilation. Unemployment is one of those things which have forced the modern industrial states to intervene and take certain measures to check unemployment. Keynes very strongly supports State intervention in order to eliminate depression and unemployment".[3]

State control to relieve pressure of unemployment has been recognised by almost all the modern states. It is self-evident in the form of the New Deal Legislation in the U.S.A., in White Papers on Employment in England, Canada, Australia and Sweden in 1944 and 1945 respectively. Then Council of Europe adopted full employment as its goal in 1950. Japan carried out most of its industrial development programmmes with the help of the State. Islam also recommends limited

1. *General Theory*, op. cit., p. 220
2. *Ibid.*, p. 159.
3. *Ibid.*, p. 320.

State control in order to protect and safeguard the interest of the community.

The Zero rate is considered a legal rate of interest in an Islamic State and any upward movements from this rate are regarded inequitable, unjust and, therefore, illegal. The gist of the entire body of literature on the conception of interest can be summed up in these words : that any excess over and above the loan capital in cash or gold or silver or food articles or other goods of use irrespective of economic conditions is interest (Riba) and therefore illegal. Thus all forms of transactions, whether in money matters or in barter, in which the element of interest is involved are forbidden in an Islamic Economy.

The State allows freedom of enterprise and individual initiative to earn profits but no profits are allowed on accumulated stock of wealth. Every individual is at liberty to do whatever he likes provided he does not endanger the welfare and security of the State. The institution of interest is one of those variables which affect the social welfare of society negatively and is, therefore, not left in private control. And this is in no way uncommon in modern society, to curb the rate of interest by any means at its disposal, even by invoking the sanctions of moral law.[1]

The final injunction of the Holy Qur'an which prohibits taking (or giving) of interest and declares the zero rate as the only legal rate of interest in the Islamic State, is as follows :

> "O you who believe ! Keep your duty to God and relinquish what remains (due) from interest, if you are believers. But if you do (it) not, then be appraised of War from God and His Messenger ; and if repent, then you shall have your capital. Wrong not, and you shall not be wronged". (2 : 278)

This verse of the Holy Qur'an makes it absolutely clear that the institution of interest can never be tolerated in an Islamic Economy. It lays down very clearly that any rate above the zero rate is a usurious rate of interest and, hence, illegal. According

1. *General Theory*, op. cit., p 352.

to the definition of usury given by the Oxford Dictionary, quoted earlier, any excessive rate specially over and above the legal rate fixed by the Government is a usurious rate of interest. Our legal rate, as declared in the Holy Qur'an is zero and every rate above this is regarded usurious rate of interest in our society.

This verse implies that the selfish profiteers who, in their "peculiar zest for making money quickly" very often forget and ignore social good which rarely coincides with that which is most profitable.[1] In order to protect the economy and to encourage the flow of capital into enterprises which are socially advantageous though not necessarily the most profitable, an abolition of interest is essential. And thus it is able to get rid of many of the evils of capitalism without destroying efficiency, freedom and individual initiative.

If these people obey the commandment of God and co-operate with the State in its socially advantageous policy reflected by the zero rate of interest, their personal interests and individual freedom are honoured and safeguarded in every walk of life as hinted in the words, "Wrong not, and you shall not be wronged". All the objectionable features of capitalism tend to disappear under this economy and every man is still able to accumulate his income in order to spend it at some later date but the accumulation does not grow by earning a rate of interest.[2]

As the State deliberately controls and supports the zero rate the institutional and psychological factors, which set a limit much above zero to the practicable decline in the rate of interest, are not able to provide any effective obstacle in the way of successful operation of this policy. Besides, legal action of the State is further strengthened in practice by the moral support it carries with it from the injunction of the Holy Qur'an, which appeals to the believers and enjoins upon them to keep their duty to God and relinquish what remains due from interest.

This policy is very successful in maintaining a zero rate of interest because it appeals to the ethical values of the people,

1. *General Theory*, op. cit., p. 157.
2. *Ibid.*, p. 221.

as being reasonable, just and practicable and, above all, in the public interest. And, as the people have complete confidence in the correctness of this policy and that it is the right decision and in their own interest, it will certainly stay.[1]

Thus the State policy to which the public opinion is readily acquiesced and has their full co-operation will be very effective and successful in its practical results. There are few, if any, evasions and the results achieved are far more significant and beneficial than can be hoped for through any State policy. As a result, the economy is completely protected and safeguarded from the selfish and reckless profiteers. There is neither over-optimistic expectations as to the future yield of capital assets current in the market nor is there any encouragement from speculators, nor fear of sudden and catastrophic fall in the marginal efficiency of capital.

The economy is completely rid of the evil consequence of trade cycles, and economic crises. Slumps and crises do not occur and the economy is able to maintain its rate of growth at full employment.[2] The institution of interest and a misguided state of expectations which are mainly responsible for booms to end in slumps, are conspicuous by their absence. Hence the economy is freed from occasional and temporary booms followed by long periods of slumps but still enjoys the benefits of an everlasting boom.

Thus it enables the booms to last permanently and, thereby, keep the economy in a quasi-boom condition. The dream of Keynes becomes reality in this society when boom is made to stay. According to him, "the right remedy for the trade cycle is not to be found by abolishing booms and thus keeping us permanently in a quasi-slump, but in abolishing slump and thus keeping us permanently in a quasi-boom".[3] And the best and the only effective way to achieve these results is to keep the rate of interest at a very low level approaching zero.

And it is very likely that when the brake of money rate of

1. *General Theory*, op. cit., p. 218.
2. *Ibid.*, p. 316.
3. *Ibid.*, p. 322.

interest does not exist to check the growth of capital, there will be such a rapid growth of capital that it will cease to be scarce.[1] Consequently, abundance of capital will have provided enough justification for a zero rate of interest.

The Policy also provides adequate inducement to investment. Every socially advantageous project which could not be undertaken before because of its low marginal efficiency of capital (i.e. marginal productivity) and high rate of interest would be feasible in an interestless economy. Even the projects with zero marginal efficiency of capital would be undertaken in such an economy. In consequence, there would be tremendous increase in the rate of investment and, hence, in the level of employment in the country.

Further stimulus to investment is provided by the redistribution of incomes through the compulsory levy of Zakat. All types of wealth including uninvested cash, hoarded money, gold, silver and jewellery etc., held for one complete year, as explained in another Chapter, are subject to Zakat at a rate of $2\frac{1}{2}\%$. This levy helps to increase the rate of investment as well as to raise the propensity to consume. Keynes' fear that "a serious fall in the marginal efficiency of capital tends to affect adversely the propensity to consume",[2] even if true, does not materialise in this economy where marginal efficiency of capital is not liable to such wide fluctuations as Keynes imagines in a capitalist society. Besides, Zakat provides a tremendous boost to consumption, both public as well as private, so as to undermine the adverse effects, if any, of the fall in the marginal efficiency of capital.

In addition, Zakat discourages the holding of liquid assets in the form of cash. There are many factors which tend to increase the liquidity preference, the outstanding impediment to the growth of wealth. The people, in the past and the present, have failed to maintain the rate of investment at a level high enough to ensure full employment owing mainly to

1. *General Theory*, op. cit., p. 357.
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1. *General Theory*, op. cit., p. 357.
2. *Ibid.*, p. 319.

this preference for liquid assets.[1] Islam has provided a very strong and effective check to the preference for liquidity of money, the chief obstacle in the way of human progress, in the shape of Zakat.

The liquidity preference is completely shattered by the imposition of Zakat. If some people still decide to hoard their wealth, in spite of this, the recurring annual levy of Zakat tends to deplete their treasures. They are, therefore, forced to invest, sooner or later, their hoarded wealth and pay Zakat out of their profits instead of paying it out of their accumulated wealth. Thus all capital tends to flow into channels of investment and none or very little capital remains in liquid assets.

Both the instruments, zero rate of interest and Zakat, help in creating conditions of full employment in the community; the former by stimulating investment and the latter by accelerating investment as well as by increasing consumption.

Another important measure (discussed in another Chapter) which helps in increasing the propensity to consume and thereby the level of employment, is the "Law of Inheritance". Under this Law, sons, daughters, fathers, mothers, wives, brothers, sisters etc., all of them succeed to a person's inheritance which must be opportioned among all of them according to a definite code. As a result, all the accumulated wealth of a person is distributed among his heirs, male as well as famale, after his death. This helps in diffusing concentrated wealth among many people in the community and, consequently, increasing the propensity to consume.

And when this Law is working in conjunction with the zero rate of interest and the institution of Zakat, it would achieve the desired results in a much shorter period.

In order to further assist and stabilise the conditions of full employment, Islam enjoins upon the believers spending of their wealth freely in adversity and in prosperity alike. The Holy Qur'an while enumerating the qualities of the righteous man, says :

1. *General Theory*, p. 351.

"Those who spend (freely), whether in prosperity or in adversity," (3 : 134)

And again in Sura Al-Nisa :

"And what burden were it on them if they—spend out of what God has granted them as sustenance". (4 : 39)

These and many other verses of the Holy Qur'an (discussed in another chapter) provide more than adequate inducement to consumption and thereby to employment.

Islam thus tends to increase by these means both investment and consumption and thereby employment which is the only practical solution of the problem. According to Keynes equation ; where National Income is equal to the Value of Output or the sum total of its consumption and investment, i.e. :

$$N.\ I. = P = C + I$$

If we want to increase the National Income of a country, or in other words, the value of total output to ensure full employment and raising the standard of living of the people, then we must increase its consumption or investment or both.

Islam tries to maximise both investment and consumption in the economy by the legal zero rate of interest, Zakat, Infaq and the law of Inheritance so that under-developed countries may develop in the shortest possible time ; while the industrialised and full developed countries may be able to achieve full employment and, at the same time, be able to make its condition of boom last permanently.[1]

In short, if these measures are adopted simultaneously as complementary to one another, they would certainly achieve full employment in less than a generation and maintain conditions of boom permanently in the economy.

1. Keynes, op. cit., p. 325.

Chapter 14

ZAKAT—I

(POOR TAX)

1. Meaning

The word Zakat means to grow, to purify, to improve; it refers to that purity of the self which is acquired after the payment of obligatory contribution of Zakat. It is the goodness of the heart one attains when one is neither miserly nor has love for wealth (for its own sake). Wealth is dear to everyone and everyone loves his property and other sources of wealth; but the one who spends this wealth on others attains goodness and purity. This is his real growth and goodness which he acquires by paying the obligatory contribution levied on his wealth in the form of Zakat. It is because of this spiritual aspect of Zakat that it is not levied on non-Muslims for they could not be forced to perform any act of worship enjoined by Islam. This aspect of Zakat is described in Sura al-Taubah in these words:

"Take alms (Zakat) out of their property——thou wouldst cleanse them and purify them thereby". (9 : 103)

The Prophet's acceptance of alms (Zakat) from the people is here spoken of as an act of purifying them of the evil of wealth. The word 'Zakat' itself shows that, wealth which is not spent judiciously and wisely on one's self or on others, generates evil (by encouraging unproductive and luxurious industries and creating rivraly and class struggle) in society. It is only when wealth is spent on good things that it grows and purifies society of its evils (by encouraging the development of healthy, useful

Moreover, it does not remain confined to the purification of one's own life but spreads all round and covers the lives of all those who come in contact with him. In other words, it means that the people who pay Zakat are those who actually do the work of purification. First they purify themselves and then they serve others to enable them to attain purification. Thus they grow true qualities of humanism in themselves and then try for its growth in the lives of others. This function of Zakat is described at several places in the Holy Qur'an. In Sura al-Ala, it is referred to in these words:

"He indeed is successful who purifies himself".

(87 : 14)

And in Sura al-Shams:

"He is indeed sucessful who causes it to grow and he indeed fails who buries it". (91 : 9-10)

"Zakka" means to make something to increase or grow; while "Dassa-ha" means to conceal or bury it and not to let it grow. Thus one purifies and assists in the process of growth; while the other checks growth and causes it to become stagnant and corrupt. The use of these two words really indicates that the faculties necessary for growth, development and perfection are given to every man; there are some who make them thrive and grow through their proper use and development; while others make them stagnant and stale by allowing them to remain unused, underdeveloped and concealed, for they do not use them properly to their advantage.

2. Zakat and Sadaqat

There seems to be confusion in the minds of some writers with regard to conception of Zakat and Sadaqat. Some of them, simply for lack of proper understanding, fail to distinguish between the two terms and often confuse Zakat with Sadaqat and vice versa. But some of them quite deliberately try to give their own meanings to these terms. It seems that, they are either too much impressed by communism and its recent achievements in science and technology or consider the traditional meaning too narrow to fit in and satisfy their

Western ideology. Therefore, they have attempted to introduce their own conception in these terms.

According to these writers,[1] Zakat refers to the ordinary budget of the Government and includes taxes and other items of revenue to meet the ordinary demands of expenditure; while Sadaqat refers to those gifts and contributions which are collected by the Government to meet its emergency requirements. These meanings have been arbitrarily given to the above terms without any authority from the Holy Qur'an and the Sunnah. This shows lack of understanding of the text both in its particular meaning with reference to the context and the general meaning applicable to other similar or alike situations.

Sadaqat is a very wide term and used in the Holy Qur'an to cover all kinds of charity. Sadaqat means to give alms, and also legal alms for which the word Zakat is used in the Holy Qur'an and the Sunnah. Zakat has been called Sadaqat because it is also a kind of compulsory charity. It is an obigatory Sadaqa while ordinary Sadaqat are voluntary. It is collected by the Government as a compulsory levy while the other Sadaqat are paid voluntarily. Its rate and exemption limit (nisab) are fixed while the amount of other Sadaqat depends entirely upon the will of the giver.[1]

When Sadaqat are meant to convey the meaning of a compulsory levy (Zakat), they are referred to as فريضة من الله, (a duty from God). As such, it is the duty of every Muslim (who owns wealth above nisab) to pay and offer the State to collect it. This is, quite obviously, the position of Zakat.

The rate of payment, exemption limit and other rules and regulations concerning Zakat are determined by the State. Its method of disbursement is clearly stated in the Holy Qur'an while its rate and Nisab were fixed by the Holy Prophet and strictly adhered to by his companions.[2]

Furthermore, Zakat is considered to be an act of worship next to prayer, therefore it cannot be treated like an ordinary

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1. Naeem Siddiqui, *Muashi Na-hamwarion-Ka-Islami Hal* (Economic Inequalities and their Islamic Solution), p. 343.
2. *Ibid.*, p. 345.

and productive industries). Then in Sura al-Baqarah, it is said :

"Those who spend their wealth to seek Allah's pleasure and to strengthen (the roots of their faith) in their souls". (2 : 265)

It may here be pointed out that the Holy Qur'an has used the words Sadaqat, Infaq and Zakat for alms and charity for the poor. They are in fact the three sides of the same picture; their true purpose is the moral training of man and the purification of his soul. The first two, i.e. Sadaqat and Infaq, are optional but the latter, i.e. Zakat, is compulsory and obligatory on every Muslim.

In the above verse of the Holy Qur'an, is described the parable of the people who succeed and reap the fruits of the sacrifices they make (for the good and welfare of society). The act of those who spend their wealth for the good and welfare of society is referred to in the above verse of the Holy Qur'an as "spending to seek Allah's pleasure" and "for the strengthening of their souls". It clearly indicates the great significance of wealth that is spent for the good of the people without expectation of a reward in return.

In fact Zakat is called 'Zakat' because it helps purifying human soul (of selfishness, miserliness and love of wealth) and thereby opens way for its proper growth and improvement (through expenditure on others). Zakat is not mere charity but a necessary step towards human progress. The wealthy by helping the poor members of the community, in fact, help themselves. If they deny this share to the poor, they damage their own selves. They refuse to help in the building of humanity. In other words, they leave the main highway of human progress and get lost on the innumerable minor roads of stagnation and waste. They do not wish therefore, that their souls be purified of the evil indulgence and luxury.

The payment of Zakat is real obedience to God and, it shows its result in the character and dealings of the people who make such contributions. The Holy Qur'an depicts the piety and goodness of these people in the following words :

"The faithful pay Zakat very humbly ; and whatever they pay they pay with their hearts full of fear (of God)". (23 : 4)

The word Zakat, as explained above, performs two important functions. Firstly it purifies the soul of the contributor from the evils of niggardliness and, instead, encourages charity and expenditure of good things. The people who really understand the significance of Zakat and make this payment to attain goodness and purity of soul which comes from the payment of Zakat, are very humble and God-fearing. They will do all the good things in the world simply to please God and will never boast of their good deeds. All this is conveyed by the word Zakat.

Secondly it leads to the healthy growth of the community. It discourages all influences which hinder and encourages those which assist in the achievement of economic progress. By making it a duty of every wealthy Muslim to pay Zakat on his wealth, property, commercial goods etc., it provides a very strong stimulus to the people to invest their capital so that it may grow and thereby increase the total wealth of the community. Both these ideals of purity of soul and economic growth are conveyed by the word Zakat.

Furthermore, when the word Zakat refers to purity, it conveys two meanings. In the first instance, it refers to that wealth which is paid to attain purity and goodness of soul. Wherever in the Holy Qur'an the words يوتون الزكوٰة are used, they simply signify that the contributors pay a share of their wealth for purifying their souls, Thus the object of Zakat here is confined to the payment of due share which helps in purifying the soul of the contributor.

In the second place, its refers to the actual act of purlfication. The use of the words والذين هم للزكوٰة فعلون conveys the second meaning. [1]The people who pay Zakat do perform the act of purifying. In this sense, the act of purifying is not confined to mere payment of material Zakat but includes purity of soul, purity of character, purity of life, purity of material wealth and, in fact, covers all the aspects of human life.

1. Maulana Abul A'la Maududi' *Tafheem-al-Qur'an*, 23 : 4.

Moreover, it does not remain confined to the purification of one's own life but spreads all round and covers the lives of all those who come in contact with him. In other words, it means that the people who pay Zakat are those who actually do the work of purification. First they purify themselves and then they serve others to enable them to attain purification. Thus they grow true qualities of humanism in themselves and then try for its growth in the lives of others. This function of Zakat is described at several places in the Holy Qur'an. In Sura al-Ala, it is referred to in these words :

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2. *Ibid.*, p. 345.

tax of the Government. It is incumbent upon every Muslim to pay Zakat levy, collectively if there is a Muslim Government and individually if there is non-Muslim Government. Besides, it is meant to purify a Muslim, spiritually, mentally and morally. An ordinary tax is only an item of revenue levied by the Government to increase its income and has no moral or spiritual significance.

3. A Tax or A Religious Duty

Now the question arises whether Zakat is a general tax or an obligatory duty upon the Muslims only. Some Muslim economists regard it as a kind of tax because it fulfils some of the conditions of a tax. Ordinarily a levy which fulfils the following conditions is considered a tax by the economists.

(*a*) It is a compulsory payment ;

(*b*) There is no Quid Pro Quo ; and

(*c*) It is levied on all citizens of the State.

Zakat fulfils the first two conditions but not the third one. It is a compulsory payment and there is no Quid Pro Quo ; but it is levied upon the Muslim members of the State only and the non-Muslims are exempt from its payment. Therefore Zakat is not a tax in the real sense of the term.

It is in fact, like prayer or pilgrimage, a form of worship or a religious duty based on entirely different psychological feelings than an ordinary tax. People hate paying taxes to the Government and many times try to evade the payment or at least manage to get reduction. It is a burden on the people which is never liked by them. Zakat, on the other hand, is a religious duty and is performed very zealously to seek the pleasure of God by the majority of the Muslims all over the world ; even if there is no official arrangement for its collection. In many of the Muslim States, people come in hundreds of thousands to private institutions and orphanages to pay annual Zakat on their property.

Zakat is considered as one of the five pillars of Islam and, obviously, such an important position cannot be given to any tax, however important it may be. Then the income from

taxes can be spent by the Government on its multifarious requirements without any considerations for the revenue from any single tax ; whereas in case of Zakat, the Muslim Government is given special instructions by the Holy Qur'an as to how and where to spend the revenue from the collection of Zakat. The Government has no option but to disburse the Zakat revenue on items specified by the Holy Qur'an.

Thus Zakat is not a tax in the ordinary sense of the word but is a special tax which is not levied upon the Muslim members of the State only and is paid by them as a religious duty to please God. The income from Zakat is regarded as a special kind of revenue by the Government and is spent on certain specified items of expenditure enumerated in the Holy Qur'an. The difference between Zakat and an ordinary tax may be summarised as follows:

(*a*) Zakat is a religious duty and an act of worship whereas a tax is only an economic expediency adopted to collect revenue for the State.

(*b*) Zakat is levied upon the Muslim members of the State only ; whereas an ordinary tax is generally levied upon all members of the State irrespective of caste, creed or colour.

(*c*) Zakat is an obligatory duty upon the Muslims which must be paid under all circumstances and can never be remitted. A tax, on the other hand, can be remitted by the Government of the time.

(*d*) The source and the rate of Zakat are determined by the Holy Qur'an and the Sunnah and can never be changed by any person or Government. The source and the rate of a tax, on the other hand, can be changed from time to time according to requirements by the Government of the country.

(*e*) Items of expenditure and the beneficiaries of Zakat are also enumerated by the Holy Qur'an and the Sunnah and no person or Government has the right or power to change them ; whereas tax expenditure can be changed or modified as required by the Government.

(*f*) Zakat is received from the wealthy and is spent on the poor and the needy ; while an ordinary tax benefits the rich as

well as the poor and may, under certain circumstances, benefit the former more than the latter.

(*g*) Furthermore, Zakat, unlike an ordinary tax, is levied not only on money capital but on commercial goods, agricultural produce, animals, minerals including gold and silver and ornaments etc. In short, Zakat is levied on the total wealth which has remained with the owner for a full year and not on savings.

(*h*) Zakat is levied fundamentally to check uneven and inequitable distribution of wealth and concentration of wealth in fewer hands ; while an ordinary tax is levied mainly for revenue purposes.

4. Importance

Importance of Zakat can be judged by the fact that it has been included among the five pillars of Islam. There is no doubt that it occupies a very important place in Islam, second only to prayers. The commandment to perform prayers in the Holy Qur'an is invariable followed by Zakat and with the same emphasis. In Sura al-Baqarah the Muslims are commanded to keep up prayer and pay Zakat in these words :

(*a*) "And keep up prayer and pay Zakat. And whatever good you send before for yourself, you will find it with God". (2 : 110)

The Muslims are emphatically told in the above verse of the Holy Qur'an that whatever they spend to seek the pleasure of God in the form of Zakat will not be wasted but will bear fruit both in this world and the Hereafter.

The payment of Zakat is described as one of the qualities of a true believer in Sura al-Barsaat in the following words :

(*b*) "Only he can maintain the mosques of God who believes in God and the Last Day, and keeps up prayer and pays Zakat and fears none but God". (9 : 18)
and further in the same Sura :

(*c*) "And the believers, men and women, are friends one of another. They enjoin good and forbid evil and keep up prayer and pay Zakat, and obey God and His Messenger". (9 : 71)

In these and many other verses of the Holy Qur'an payment of Zakat is mentioned along with prayers which shows the great importance of this obligatory payment in (the economic system of) Islam. It is observed as regularly as prayer and other tenets of Islam so much so that non-payment of it is described as a sign of non-believers in the Holy Qur'an :

Along with the confession of the faith, it is essential that the converts should keep up prayer and pay Zakat. This is the only practical way of proving one's belief in God. Anyone who confesses his faith verbally but does not pay Zakat cannot be regarded a true Muslim. At least there is no practical proof of his faith. After the death of the Holy Prophet, when many Muslims refused to pay Zakat, Abu Bakr, the First Caliph, declared war on them and quoted the following verse of the Holy Qur'an :

> "Wherever you find them, and take them captive and besiege them and lie in wait for them in every ambush. But if they repent and keep up prayer and pay Zakat, leave their way free". (9 : 5)

One section of the Muslims, including 'Umar, objected to this action of the Caliph on the ground that they could not declare war on the Muslims so long as they were observing other tenets of Islam. Even one group of the rebels said that they were not disbelievers, and that they observed prayer but they would not pay Zakat. Abu Bakr referred to the above verse of the Holy Qur'an and said, "We are commanded to abstain from declaring war on such people only when they repent, keep prayer and pay Zakat. When they break any one of the three conditions, how can we leave them".[1]

> "It is this importance which enrobes Zakat with a religious sanctity of the highest order and thus makes the realisation of this tax easy, inexpensive and voluntary. The greater the hold of Islam on a people,

1. S. A. Siddiqui, *Public Finance in Islam*, (1962), p. 9.

the less the chances of evasion".[1]

So far we have discussed the importance of Zakat as a religious duty and as an act of worship like prayer or pilgrimage. We would now like to discuss its importance mainly as a collective obligation on society and as an important measure of achieving economic progress by reducing inequalities of wealth.

Zakat is a compulsory levy which every member of the Muslim community who satisfies the necessary condition (of Nisab), must pay it under all circumstances. The collective fund is utilised for the uplift of the less fortunate members of the community. In a way, it constitutes a co-operative society, an insurance company, a provident fund of the Muslim community. Any member of the community, who needs help of any kind, is provided help from this fund. So it is an auxiliary capital maintained by the community to help the unemployed, the poor, the needy, the orphans, the widows, the invalids, the sick etc. It is such an important social insurance for every member of the Muslim community that no one should ever worry about his future.[2]

It is an Insurance Fund to which only the wealthy make contributions. If you are rich today, you contribute to this Fund. The needy and the poor benefit from this Fund today but if you (or your children) are rendered poor tomorrow by the vicissitudes of this world, you (or your children) will also benefit from it. Thus no member of the Muslim community need ever feel insecure financially for himself, his wife or children after him because the Social Insurance Fund (Zakat) would always look after the interest of the needy and the poor. A Muslim should, therefore, never worry himself even about unforeseenable catastrophes, such as diseases, fire accidents, floods, bankruptcies, death etc., which might wreck his career, destroy his property or business and render his descendants penniless, for the Zakat Fund is his permanent Insurance against all types of risks.

1. S. A. Siddiqui, *Public Fainance in Islam*, (1962), p. 9.
2. Maulana Abul A'la Maududi, *Islam aur Jadid Muashi Nazriyyat*, pp. 130-131.

Even when one is on a journey and becomes penniless through theft, sickness or other reasons, this Fund will meet all one's needs. Thus Zakat serves both purposes of purification of self, being a religious duty and Social Insurance against all kinds of risks, being a collective contribution.[1]

5. Aim of Zakat

One of the most important aims of Zakat is to narrow down the economic-inequalities in the community to the minimum possible limit. Its purpose is to keep the economic differences among the people within just and equitable limits so that the rich may not grow richer (by exploiting the less fortunate members of the community) and the poor poorer. "The Holy Prophet described Zakat as money taken from the rich and returned to the poor. Its aim is, therefore, to distribute the wealth of the community in such a manner that no Muslim is left poor (and destitute)".[2]

> "The power of any community rests upon a just distribution of wealth. If some people grow very rich and most people remain poor, the community becomes weak and is easily destroyed by the enemies (and internal class rivalries). Money is like blood in man's body. If blood does not reach all parts of the body, some parts take up so much blood that other parts receive too little, then the body becomes sick and diseased. Therefore, to prevent too much money going into the hands of the rich, Islam has ordered the rich people to pay Zakat".

Thus it is a religious duty of the rich members to pay Zakat in order to help the poor members of the Community. In this way Islam keeps the wealth of the community in circulation and does not let it concentrate in few hands. This fundamental principle of Islam is stated in the following words :

1. Maulana Abul A'la Maududi, *Islam aur Jadid Muashi Nazriyyat* pp. 130-132.
9. *Lessons in Islam*, Book III (1961), published by Sh. Muhammad Ashraf, p. 11.

"What God has bestowed on His Apostle—belongs to God—to His Apostle and to kindred and orphans, the needy and the wayfarer ; in order that it may not (merely) make a circuit between the wealthy among you". (59 : 7)

This verse of the Holy Qur'an, in its wider application, makes it quite clear that concentration of wealth in few hands is unnatural, unjust and inhuman and therefore can never be tolerated. It does not mean that the rich people should be robbed of their wealth but what it suggests is that economic inequalities among the people (or different sections of the community) should not be allowed to grow beyond just and reasonable limits so that a few rich people should indulge in luxuries at the cost of the great mass of the people who might be left in poverty and hunger.

A community which tolerates and encourages economic inequalities among its members cannot be called a Muslim community. In fact, such a society, where a few rich people enjoy a life of self-indulgence and luxury and millions are left to lead a life of hunger and starvation, cannot survive for a long time. The Holy Prophet emphatically condemned such a society in the following words (Musnad Ahmad) :

(*a*) "A town, in which a man sleeps hungry and wakes up in the morning hungry, loses the promise of protection and safety from God".

(*b*) "The Holy Prophet is reported to have said that "none of you is considered true in faith until he likes for his brother (Muslim) what he likes for himself".

Thus a community which allows economic inequalities to grow within itself and leaves its poor population to live and die in hunger and starvation is doomed for ever. It can erupt at any moment by the explosions of antagonistic forces within its fold.

This illustrates the basic difference between Islam and capitalism. Under capitalism, accumulation and concentration of wealth is encouraged. Money is lent on interest to grow on other people's wealth which leads to further concentration

of capital in fewer hands. Islam, on the other hand, spreads out wealth in the community through Infaq, Sadaqat and laws of inheritance and provides no opportunity to wealth to concentrate at any stage of production or distribution. If, in spite of these measures, wealth does concentrate at any point, it opens up channels of Zakat from such reservoirs to irrigate the dry lands in the community. Thus Zakat seems to be a very effective method of bridging the gulf between the "haves" and the "have-nots." It helps in narrowing down the economic difference among the people so effectively that no one is left poor or destitute in the community.

In view of its grave social, economic, political and moral dangers, Islam does not permit excessive inequalities of wealth among its members. It has, therefore, levied a compulsory payment in the form of Zakat upon the wealthy members of the Muslim community to help the poor and the destitute among them. Thus the sole purpose of Zakat, in addition to the purification of the self, is to remove excessive and unjust inequalities of wealth among different sections and individuals of the community.

6. Principles of Assesment

"In a society which allows private property and individual initiative in all the walks of life, difference in acquisitions are bound to occur, but these differences must not be allowed to create classes of the rich and the poor with unpassable social gulf between them as we find today in the capitalist countries. Efforts must be made to level up and level down by methods which the people should believe to be morally right and just. Out of the funds secured by Zakat and other methods of Infaq and Sadaqat, the needy and destitute are rehabilitated by the State. And as the Holy Qur'an says, the needy have a right on the wealth of the rich".[1]

1. Dr. Khalifa Abdul Hakim, *Islam and Communism*, (1962), p. 190

"And in their wealth is the right of his who asks, and him who is needy". (51 : 19)

Note that the poor are spoken of as having a share in the wealth of the rich. The rich do not give any share of their own wealth in the form of Zakat but give back only what belongs to the poor. Therefore they must not feel any pride or sense of superiority in returning something which never belonged to them. It is the duty of the State to take that share from the rich and hand it over to the poor. It may, however, be remembered that it is only a share, not the whole, as the communists would have said.

"And to illustrate this principle the Holy Prophet is reported to have said that, after all, the wealth and comforts of the rich are the products of the labours of the poor. That is why he spoke of Zakat as an income, taken from the rich and returned to the poor".[1]

Besides, it is the intention of Islam that its economic system should be so organised that wealth would not circulate among the rich only, as explained earlier.

"Islam desires to mould the economic life of society in such a manner that antagonistic class-divisions of millionaires and paupers should not come into existence".[1]

All its efforts are directed towards the creation of such a society. All surplus should come to the State in prescribed proportions and administered by the State, so that no individual should feel any shame in being obliged to receive financial or other assistance at private hands. And it is considered the duty of the State to look after the interests of its members so that no one is deprived of the fundamental needs of life.

It is, therefore necessary that the principle (or principles) underlying the institution of Zakat should be studied in the light of the verses of the Holy Qur'an and the Sunnah. The same principle determines the share of the State in the form of Zakat from various kinds of incomes.

1. Dr. Khalifa Abdul Hakim, *Islam and Communism*, (1962), p. 190.

The main principle underlying Zakat is that its burden is heavier where it pinches less and lighter where it pinches most. If the income is earned without any hard labour, a higher rate of Zakat would neither be burdensome nor would it deter efforts on the part of the payer. On the other hand, if the income is earned with hard labour, a higher rate would not only be felt very strongly but would also discourage hard work. Therefore the rate of Zakat on such incomes is very low.

Thus the proportion of the State share in the form of Zakat is greater in incomes earned without much labour (or unearned incomes) as compared to incomes earned with hard labour (earned incomes).

For instance,[1] "the share of the State in treasure-trove is 1/5th, 1/10th to 1/20th in land produce and 1/40th in gold, silver and articles of trade. It will, therefore, be noticed that the proportion of the State share works out to a progressive figure ranging between 1/40th and 1/5th. The main principles underlying this differentiation in the matter of different kinds of income can be summarised below":

(*a*) It is a levy entirely upon the rich members of the community for the benefit of the poor and the needy.

(*b*) There is absolutely no "Quid Pro Quo", i.e. return benefit to the rich for this levy. The rich who pay this levy do not derive any benefit from this fund. They only contribute towards this fund which is reserved wholly for the use of the poor members of the community.

(*c*) It is levied on the Muslim members of the community only.

(*d*) "The lesser the amount of labour and capital involved in the accrual of an income, the higher the rate of Zakat levy and conversely the greater the amount of labour and capital, the lower the rate of levy".

(*e*) "No Zakat is charged on things which are perishable in a few days, such as vegetables."[2]

1. S. A. Siddiqui, op. cit., pp. 10-11.
2. *Ibid*., pp. 11-13.

(*f*) "Things which are not used for further production, e.g. household effects, animals used for riding, conveyance, residence, tools etc., are not subject to Zakat levy".

(*g*) "Animals which do not breed or breed seldom or after a long time (e.g. mules, which come under the first category and elephants, who fall under the latter) are not subject to Zakat".[1]

"The fourth principle mentioned above needs some elucidation. It requires that the rate of Zakat shall vary with the amount of labour and capital expended in the accrual of an income. There cannot be a more natural basis for determining the rate of Zakat. In fact, all wealth is the result of the application of capital and labour (and direction in industrial enterprises) and it is equitable to pay due regard to the amount of capital and labour expended by an individual as compared with one who has earned an income without much labour and expenditure (or unearned income such as from rise in the price of property etc.) Thus, if an individual comes across a treasure-trove, he obtains it accidentally and without much labour and expenditure. In such a case, the share of the State should naturally be maximum, i.e. 1/5th of the entire find".[1]

"On the other hand, the ploughing of land and making it yield produce or the laying out of a fruit garden needs considerable labour and capital. Due allowance has to be made for it and therefore the rate on the produce of land is less than that on treasure-trove. It is 1/10th of the produce. Here the principle is carried a little further, in that difference is made between irrigated and unirrigated land. If the land has been irrigated by the labour and capital of the cultivator, the rate is fixed at 1/20th ; whereas if no labour and capital has been employed by the cultivator,

1. S. A. Siddiqui, op. cit., pp. 11-13.

i.e. when the land is dependent wholly on rainfall or where it is irrigated by natural canals and ravines, the rate is 1/10th. The difference between 1/10th and 1/20th represents the cost of labour and capital used in irrigating the land".[1]

"Further, the rate of Zakat on gold, silver and articles of trade is reduced to 1/40th. Here again the same principle operates. The accumulation of gold and silver is a more difficult process than the cultivation of land. The businessman, besides taking risk of loss, applies not only labour and capital in a greater degree, but direction and intelligence as well and is consequently entitled to a greater regard than the cultivator and more. The subjection of gold and silver to the same as applied to land produce, would have constituted a discouragement to business enterprise and might have resulted in its possible ruination and thus it is necessary to subject it to its lowest rate. In other words, this low rate of Zakat is intended primarily to encourage trade and industry. It is a kind of tax concession for people involved in trade, commerce and industry".[1]

"Finally, it is a matter of common knowledge that a cultivator has not only fewer wants but meets a majority of them (or his primary wants at least entirely) from his own land. He is thus at a greater advantage than, for example, a merchant who is generally an urbanite and has to pay in cash for every want besides meeting other demands incidental to life in a city".[1]

1. S. A. Siddiqui, op. cit., pp. 11-13.

Chapter 15

ZAKAT—II

7. Assessment Period

Zakat is levied on capital of various types which has accumulated as a surplus at the end of each year. It is levied annually on capital (not investment) after deducting necessary expenses at the end of the year. All types of capital which have been in the possession of the owner for full twelve months will be subject to Zakat. The Holy Prophet clearly stated that "No Zakat is due on property before there elapses over it a year". Therefore Zakat becomes payable only when twelve months have elapsed over the property which comes within the limits of Nisab as will be explained under the heading (9) Nisab.

For purposes of Zakat, Muslim financial year begins with the month of Ramadan. Thus having purified their wealth by the payment of Zakat at the end of the year, the Muslims are completely ready to greet the Holy month of Ramadan for purifying and cleansing their body and soul as well.

8. State Responsibility

Zakat is not a new levy which is introduced by the Holy Qur'an for the benefit of the poor members of the Muslim community. The earlier prophets, according to the Holy Qur'an, also collected this levy from the rich members of their communities. Prophet Abraham and his descendants are commanded to pay Zakat in the following words :

(*a*) "And We made them leaders who guided (people) by Our command, and We revealed to them the doing

of good and the keeping up a prayer and the giving of Zakat". (**21** : 73)

(*b*) Prophet Ishmael was commanded to tell his people to pay Zakat in these words :

"And he enjoined on his people prayer and paying of) Zakat". (**19** : 55)

(*c*) When God made a convenant with Israelites, He commanded them to keep up prayer and pay Zakat which is described in the following verse of the Holy Qur'an :

"And when We made a covenant with the children of Israel : "You shall serve none but God——and keep up prayer and pay Zakat". (**2** : 83)

(*d*) Payment of Zakat was enjoined even on Jesus (and through him on his followers), as mentioned in Sura al-Maryam in these words :

"And He has made me blessed wherever I may be, and He has enjoined on me prayer and (payment of) Zakat so long as I live". (**19** : 31)

There is no doubt that every prophet was commanded to keep up prayer and pay Zakat for the purification of individual members and the prosperity of the Muslim community.

Islam has made Zakat not only a compulsory levy, but a State institution to be collected and distributed by the Government. The Holy Qur'an clearly indicates that the institution of Zakat should be established, organised and maintained by the ruling power. Maintenance of the institution of Zakat is said to be one of the important measures taken by the Faithfuls to establish an Islamic State when they gain authority in this world ;

(*e*) "Those who, if We establish them in the land, will keep up prayer and pay Zakat". (**22**: 41)

(*f*) Again in Sura al-Nur :

"God has promised to those of you who believe and do good that He will surely make them rulers in the earth——they will serve Me——and keep up prayer and pay Zakat". (**24** : 55-56)

The use of the words واقيمو الصلوٰة ـ واتوالز كوٰة shows that, these institutions are to be established and organised by the

community and not by the individuals. The individual members of the community can, no doubt, say prayers and pay Zakat as indicated by the words used in the Holy Qur'an. It is an obligatory duty on the rich members of the Muslim community and, obviously, there must be some authority to enforce its payment. A compulsory levy cannot be left entirely on the initiative of the individuals, however, pious virtuous and God-fearing they may be. It is, therefore, necessary that the collection of Zakat should be in the hands of the Government.

The decision of Abu Bakr, the first Caliph, to call a holy war on those who refused to pay Zakat should leave no doubt in the minds that Zakat is a State institution and should be collected and distributed by the State. The following verse of the Holy Quran also indicates that Zakat is a State institution:

(g) "Take alms out of their property——thou wouldst cleanse them and purify them thereby". (9 : 103)

The Holy Prophet, as the Head of the State, is here told to collect Sadaqat from the Muslim members of the State. The amount, time and the method of collection are determined by the Holy Qur'an and the Sunnah. The individuals have, therefore, no choice either in giving their Zakat to anyone they like or in determining the amount of its levy. Both the functions are considered to be the duty of the Government in an Islamic State.

9. Nisab (exemption limit)

All types of wealth, which remain in the possession of the owner for one year, are subject to Zakat, provided they exceed a prescribed limit. If the quantity of wealth is less than the minimum prescribed by the Muslim law, it is exempted from Zakat. Islam has prescribed, for each type of wealth, a minimum exemption limit called Nisab. The minimum exemption limit, in case of a debtor, will be arrived at after deducting the amount of debt from his total wealth.

After making allowance for Nisab and debt, Zakat is levied on all types of wealth at the rate of $2\frac{1}{2}\%$; mines and treasure-trove at 20% : irrigated land at 5% ; unirrigated land at 10% ;

cattle varying between 1 to 2½%. Each of these items and the prescribed Nisab and assessment rate will be discussed in detail under the section "Assessment Rate".

It may be pointed out that the exemption limit (Nisab) is prepared very carefully after giving reasonable and liberal allowance necessary for the acquisition of necessities of life (حاجة اصلية). In preparing Nisab, Islam has paid great attention to the actual and potential productivity of the things subject to Zakat. All types of wealth, which are productive at present like commercial goods, agricultural and pastural lands and animals which are capable of assisting in production, such as gold and silver, are subject to Zakat over the minimum exemption limit (Nisab). On the other hand, all articles which are considered necessities or which are not productive in the above sense, or both, are exempt from Zakat.[1] A list of such articles which are exempt from this levy is given below :

(*a*) Dwelling-houses :
(*b*) Wearing apparels ;
(*c*) Household utensils :
(*d*) Riding animals ;
(*e*) Arms for use ;
(*f*) Food etc. ;
(*g*) Articles of adornment other than gold and silver ;
(*h*) Coins, other than gold and silver, intended for personal expenditure ;
(*i*) Books ;
(*j*) Tools and machinery used for further production ; and
(*k*) Animals used in agriculture.

The above-mentioned articles are not subject to this levy so long as they are not intended for trade (or exchanged for profit).

Further, articles belonging to the same genus (kind) only are taken into consideration for purposes of Nisab. Each type of wealth constitutes a separate kind (جنس) for the levy of Zakat. For example, a man who owns animals, commercial goods and

1. S. A. Siddiqui, op. cit., p. 31.

gold and silver will be subject to Zakat on each type of wealth separately. If the three categories of wealth are severally and not jointly above the prescribed Nisab, he will then pay Zakat according to the assessment rate of each kind of wealth. But if they do not constitute the prescribed Nisab separately, they will not be subject to Zakat, even though they may constitute Nisab when added together.[1]

Zakat will be levied separately on animals, mines, treasure-trove, hoarded wealth, gold and silver (including ornaments of gold and silver), agricultural produce, etc. In case of gold and silver or ornaments of gold and silver, Zakat is levied on the total value of the two metals together. The two metals are added together in terms of value and Zakat is levied on the total value of the two metals. The prescribed minimum exemption limit (Nisab) for some of the articles is given below :

(a) Gold and Silver

In case of gold, Nisab is 7½ tolas (or three ounces) and silver 52½ tolas (or 21 ounces). For ornaments, Nisab is determined according to the metal of which the ornament is made ; if it is made of gold, Nisab will be that of gold and if made of silver, Nisab will be that of silver.

(b) Mines and Treasure-Trove

Twenty per cent of mines and treasure-trove, whether owned by the individuals or the State, is to be paid to the Zakat fund.

(c) Cattle Wealth

Animals are subject to Zakat levy ranging between 1 to 2½%.

(d) Agricultural Produce

Zakat levy varies between 5% to 10% of the land produce according to the nature of land, i. e. irrigated or unirrigated.

(e) Commercial and Industrial Goods

Zakat is levied at the rate of 2½% on all commercial and

1. S. A. Siddiqui, op. cit. p. 35.

industrial goods. Every trader and industrialist is to pay $2\frac{1}{2}\%$ of the total value of his goods to the Zakat Fund.

10. Assessment Rate

There are two types of wealth which are subject to Zakat, i.e. Visible and Invisible wealth.

(a) Visible Wealth

Visible wealth means that wealth which cannot be easily hidden to avoid Zakat levy, such as agricultural produce, herd of cattle etc.

(b) Invisible Wealth

Invisible wealth means that wealth which can be easily hidden to avoid Zakat levy, for example gold, silver, commercial and industrial goods etc.

(a) Visible Wealth :

1. Agricultural Produce

The details of Zakat levy on visible types of wealth like agricultural produce are as follows :

Assessment rate on the agricultural produce is classified on different principles. If land is cultivated by a Muslim farmer, 1/10th of the produce as Zakat which is called Ushr ; whereas land revenue collected from non-Muslim farmers is called Kharaj. The Muslim jurists have classified land, for purposes of Zakat levy and land revenue, in a Muslim state under four headings :

(i) If the inhabitants of a country embrace Islam, their land will be called Ushri and they will pay 'Ushr (1/10th of their produce) as Zakat levy to the Government.

(ii) If the Muslims bring any land under cultivation, it will be called 'Ushri and they will pay 'Ushr (1/10th of the produce) as Zakat to the Government.

(iii) If the Muslims occupy any land by force, it will also be called 'Ushri and they will pay 'Ushr (1/10th of the produce) as Zakat fund to the Government.

(iv) If land is left in the hands of the original inhabitants of a country, they are subject to land revenue tax called Kharaj.

Levy on the first three kinds of land is Zakat and is called 'Ushr, while on the last one is only a revenue tax and is called Kharaj. The authority for the levy of Zakat (i.e. 'Ushr) on the agricultural produce of land comes from the following verse of the Holy Qur'an ;

I. Sura al-An'am :

"Eat of its fruit when it bears fruit, and pay the due of it on the day of harvest" (6 : 142).

II. Sura al-Baqra :

"O you who believe, spend of the good things that you earn and of that which We bring forth for you out of the earth" (2 : 267).

The jurists have not only taken the words (مما اخرجنا لكم من الارض) to mean cereal and fruits but have also mineral wealth in it.

The Holy Prophet himself determined the rate of 'Ushr. This is contained in a letter which he wrote to Mu'adh Bin Jabal in Yemen. The Holy Prophet wrote to him that :

I. "The land irrigated by streams, rivers (running water) or rainfall (without human efforts) will pay 1/10th ('Ushr) of the produce, and the land irrigated by wells (or by artificial canal system) will pay 1/20th (half 'Ushr)".

II. According to 'Abdullah, the Holy Prophet said (Bukhari):

"In the produce of lands watered by rainfall, springs or running water (there) is ('Ushr) 1/10th, and (in) what is watered by wells (or artificial irrigation system) 1/20th (or half 'Ushr)".

The jurists have given the following reason for charging one-twentieth of the produce on the land irrigated by wells (or artificial irrigation system) :

"For more labour (and capital) is required for (digging wells and canals to irrigate) this land ; on the other hand, the land, which is irrigated by rainfall or (natural) streams, needs less labour (and capital)".

In order to determine the levy of 'Ushr, the jurists have also classified agricultural produce into two kinds, (i) Farming and (ii) Gardening.

(i) Farming

According to Imam Abu Hanifa, 'Ushr is a compulsory levy on every kind of produce, but according to Imam Shafi'i, it is compulsory only on those things which can be stored for food. 'Ushr, therefore, would not be charged on vegetables. Imam Malik and Imam Abu Yusuf are also of the opinion that vegetables and other similar (perishable) goods are not subject to 'Ushr.

According to Imam Abu Yusuf all other kinds of produce which are stored and are measured by a measure or weighted, e.g. wheat, barley, rice, corn, almonds, onions, garlic etc., and others like these, are subject to Zakat ('Ushr) provided the quantity produced is five 'wasq' or more. If the quantity produced is less than five 'wasq, there is no Zakat ('Ushr) on the produce. The above decision of Imam Abu Yusuf seems to be based on the following Hadith of the Holy Prophet :

> "According to Abu Saeed, the Holy Prophet said, "Nor is there any Zakat in what is less than five wasq (of agricultural produce)".

Imam Abu Yusuf has further classified the position of articles which are not measured by wasq, for example cotton, zaifran etc. There is 'Ushr in them provided their price is equal to five wasq of the most inferior kind of measurable articles. Thus the price of articles which are not measured, is to be judged by the prices of comparable or similar commercial goods for purposes of Zakat ('Ushr).

In case of agricultural lands, Zakat is payable at the time of harvest when the crops are reaped. If at that time, it is found that the quantity of the produce is over five wasq, Zakat will be collected ; and if the quantity of the produce is found to be less than five wasq, no Zakat will be collected.

It may, however, be pointed out that a reasonable allowance is given for the portion of the produce which has to be consumed

by the cultivator and his family is determining the exemption limit (Nisab).

(ii) Gardening

Zakat is also levied on fruits. According to Imam Abu Hanifa, all kinds of fruits, like agricultural produce, are subject to Zakat at the rate of 10% of the produce. But in the opinion of Imam Shafi'i only dates and grapes are subject to this levy. His opinion is supported by the action of Umar, the second Caliph, who charged 'Ushr on the produce of grapes and dates only. It is reported that the collector of Taif, Suffion Bin Abdullah Assakafi, wrote to Unar regarding the problem of gardens which produced grapes, peaches and pomegranates and many other fruits whose productivity was mani-fold higher than grapes. And he asked for permission to charge 'Ushr on all these fruits. Umar replied that there was no 'Ushr on these fruits.[1]

In the case of fruits, however, two conditions must be fulfilled before any produce is subjected to Zakat :

1. That fruit should ripen so as to be eatable and Zakat levy lapses if unripe or raw fruit is taken away from the trees. But if it is done to evade the levy, it is regarded as مكروه and suitable measures could be taken to check such evasions.

2. That the quantity of fruit should be at least five wasq for this is the Nisab for the levy of Zakat and there is no Zakat on any quantity of fruit less than this.

Imam Abu Hanifa forbids estimation or reckoning of the quantity of fruits which is still on the trees but Imam Shafi'i thinks that it is quite fair and legal. Imam Shafi'i's decision is supported by the action of the Holy Prophet who had appointed collectors to estimate the quantity of dates and grapes for purposes of Zakat.[2]

The rate of assessment of Zakat is determined by the nature

1. Dr. Yusuf-ud-Din, op. cit., p. 665.
2. *Ibid.*, p. 666.

of irrigation system used in the garden. If it is irrigated by running water or streams (or rainfall), 1/10th of the produce is collected for Zakat ; and if the irrigation is done by means of well or water carried on the back of a camel (i.e. by artificial irrigation), Zakat levy is 1/20th of the produce.[1]

It may, however, be pointed out that estimates of the quantity of grapes and dates should be made at the time when they reach the ripening stage or when they are considered useful or eatable. In case of dried grapes and dates, Zakat should be levied when they are absolutely dry, ready for use as dried fruit ; but in case of fresh fruits, Zakat should be levied at the sale price of grapes and dates. Different varieties of dates (as well as of grapes) should be regarded as one genus for purposes of Zakat.

Visible Wealth :

2. Cattle

The details of Zakat levy on visible types of wealth like cattle are as follows :—

Just as Muslim farmers pay 10% of their produce in Zakat, Muslim owners of animals also pay Zakat, the rate of which is determined according to the type of animals they possess. However, only those animals are subject to Zakat which are bred for growth (صوائم). صوائم literally means any animal that is pasturing. "Animals, which are used for riding or for carrying loads, are not subject to Zakat and do not come under the term صوائم ; nor does the word صوائم apply to animals pastured to be sold later, since such animals are taken into account as articles of trade and the rules concerning the two are very different".[2]

The term صوائم applies to animals pastured for their milk and offspring (نسل) in order that they may grow. Only those animals which are pastured for at least more than six months are considered صوائم. If, however, the animal is fed on preventer during six months of the year, or more it is not a صوائم

1. Dr. Yusuf-ud-Din, op. cit.. p. 666.
2. S. A. Siddiqui, op. cit., p. 50.

animal and is exempt from Zakat, unless it is subject to it as an article of trade".[1]

"In this connection, it will be relevant to recall the Hadith reported by Abu 'Abbas. According to this Hadith the Prophet (صلعم) is reported to have said, 'there is no Sadaqah on the animals used for work (عوامل) and as beasts of burden (حوامل).' Therefore, the general principle of Zakat, namely, that only such property is subject to Zakat which is sought for its physical produce and not for its use, applies in this case".[1]

Thus the only animals which are subject to Zakat, according to Sunnah, are صوائم, as enumerated below :

1. Camels ;
2. Sheep and goats ;
3. Cows, bulls, oxen and buffaloes ; and
4. Horses.

These categories of cattle are subject to Zakat varying between one and 2½% and are dealt with separately in the following :

(i) **Camels**

The rate of Zakat on camels is governed by the following Hadith of the Holy Prophet (Bukhari) :[2]

"There is a compulsory levy of one goat on twenty-four or less camels ; one goat for every five camels ; one one-year old female camel colt on twenty-five to thirty-five ; one two-year old female camel colt on thirty-six to forty-five ; one four-year old female camel colt on forty-six to sixty ; one five-year old female camel on sixty-one to seventy-five ; two two-year old female camel colts on seventy-six to ninety ; two four-year old female camels on ninety-one to hundred-twenty ; thereafter one two-year old female camel on every forty and one four-year old female camel on every fifty".

1. S. A. Siddiqui, op. cit., pp. 50-51.
2. Dr. Yusuf-ud-Din, op. cit., pp. 670-671.

"And there is no Zakat on a person who has only four camels but if the owner wants to pay, he may. There is one goat on five camels".

Simplified rate of Zakat on camels, as detailed in the above Hadith, is shown in the following table :

No. of Camels	Rate of Zakat
Up to 4	No Zakat.
From 5 to 9	1 goat.
10 ,, 14	2 goats.
15 ,, 19	3 goats.
20 ,, 24	4 goats.
25 ,, 35	1 one-year old female camel
36 ,, 45	1 two-year ,, ,, ,,
46 ,, 60	1 three-year ,, ,, ,,
61 ,, 75	1 four-year ,, ,, ,,
76 ,, 90	2 two-year ,, ,, ,,
91 ,, 120	2 three-year ,, ,, ,,
Thereafter on each 40	2 two-year ,, ,, ,,
Or ,, ,, ,, 50	1 three-year ,, ,, ,,

After that the process of determining the rate of Zakat is calculated again from the beginning but varies according to different schools of jurisprudence which we need not discuss here.

(ii) Sheep and Goats

The following Hadith governs the rate of Zakat on sheep as well as on goats (Bukhari) :[1]

"This is Zakat on goats pasturing in the forest. There is one goat due on forty to one hundred and twenty ; two goats on 121 to two hundred ; three goats on 201 to 300; thereafter one goat on every one hundred".

"And there is no Zakat on pasturing goats for less than forty but if the owner wants to pay, he may".

A summary of the rate of Zakat on goats and sheep, as stated in the above Hadith, can be seen in the following table ;

1. Dr. Yusuf-ud-Din, op. cit., p. 671.

No. of Goats or Sheep	Rate of Zakat
Up to 40	No Zakat
From 40 to 120	1 goat.
121 to 200	2 goats.
201 ,, 300	3 goats.
Thereafter on each 100	1 goat.

It may here be pointed out that the word غنم applies equally to goats and sheep and either of the two can be paid in Zakat. When the two species are mixed together, they are counted as one kind and Zakat is charged on the value of average animals.

(iii) Cows, Bulls and Oxen

[1]The Holy Prophet sent Muad Bin Jabal to Yemen with this order :

"Charge one-year old male or female calf on every thirty cows and two-year old male or female calf on every fifty".

According to Imam Malik, Muad Bin Jabal charged one-year old male calf on every thirty cows and a two-year old male calf on every forty cows. He did not charge anything for less than thirty and said that he did not hear anything with regard to this matter from the Holy Prophet and that he would enquire about this from the Holy Prophet when he would see him. But the Holy Prophet died before Muad Bin Jabal came back".[2]

It may, however, be remembered that draught animals (animals which are used for ploughing and drawing water) are exempt from Zakat. They are subjected to this levy when they are bred for purposes of trade or kept as commercial goods. Muad Bin Jabal did not charge anything for such animals and 'Ali is reported to have held the same opinion.[3]

The following table shows the rate of Zakat, as described in the above mentioned Hadith, on cows, bulls and oxen etc. :[4]

1. *Tirmizi*, quoted by Dr. Yusuf-ud-Din, op. cit., p. 672.
2. *Muatta*, Dr. Yusuf-ud-Din, op. cit., p. 672.
3. *Kitab al-Kharaj*, quoted by Dr. Yusuf-ud-Din, op. cit., p. 672.
4. S. A. Siddiqui, op. cit., p. 56.

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61 ,, 75	1 four-year ,, ,, ,,
76 ,, 90	2 two-year ,, ,, ,,
91 ,, 120	2 three-year ,, ,, ,,
Thereafter on each 40	2 two-year ,, ,, ,,
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4. S. A. Siddiqui, op. cit., p. 56.

No. of Animals	Rate of Zakat
Up to 29	No Zakat.
From 30 to 39	1 one-year old male or female calf.
40 ,, 59	1 two-year ,, ,, ,,
60 ,, 69	2 one-year ,, ,, ,,
70 ,, 79	1 one-year and 1 two-year ,, ,, ,,
80 ,, 89	2 two-year ,, ,, ,,
90 ,, 99	3 one-year ,, ,, ,,
100 ,, 109	1 two-year ,, ,, ,,
110 ,, 119	2 two-year and 1 one-year ,, ,, ,,
120 ,, 129	3 two-year or 4 one-year ,, ,, ,,

The word Baqar (بقر) is used to include all animals such as cows, bulls, oxen and buffaloes and the same rate of Zakat is charged on all these animals as that on cows. Nisab and other matters relating to assessment etc. are determined in the same way. All jurists hold similar views on this matter.

(iv) Horses

The Holy Prophet exempted horses from Zakat.[1] After the death of the Holy Prophet many pastures were discovered in the conquered territories of Syria where horses were bred and traded on a large scale. The people requested Abu Ubaidah Bin Ul juriah to take Zakat on their horses. He refused to take Zakat on horses and wrote to Umar about this matter. Umar also refused to accept Zakat on horses. The people again requested Abu Ubaidah but he refused to take their Zakat on horses and again wrote to Umar. Then Umar wrote to him to accept their Zakat on horses if they were willing to pay it.[2]

Thus Umar levied Zakat on horses by consultation with the

1. Dr. Yusuf-ud-Din, op. cit., p. 673.
2. *Ibid.*, pp. 674-675.

companions of the Holy Prophet, including Ali. In fact this suggestion that horses should be subject to Zakat levy was made by Ali.[1]

It may, however, be pointed out that, by making this decision, Umar has not in any way opposed the Holy Prophet. The Holy Prophet, while granting exemption to horses from Zakat, used the words which apparently referred to riding horses. And all the companions, including Umar, took the words of the Holy Prophet to mean riding horses only. In fact, during the time of the Holy Prophet, horses were not kept for procreation or trade purposes, therefore, the question of their exemption from Zakat did not arise at that time.[1]

The decision of Umar to levy Zakat on horses was a need of the time and in no way contradicted the decision of the Holy Prophet. Horses were never bred for trade on a large scale in the time of the Holy Prophet and so the decision of the Holy Prophet could not have covered a thing which did not exist at that time.

According to Imam Abu Hanifa, pasturing mares are subject to Zakat at the rate of one dinar per head. "The owners have the option for paying a dinar for each horse without regard to the requirements of Nisab or of appraising them, and, if, their value amounts to the Nisab, of paying at the rate of 5 dirhams for every 200 dirhams".[2] Umar is reported to have supported the method of fixing the price of the horses.

(v) Cash Payment

There is no doubt that the rate of Zakat on animals was calculated and collected in terms of animals in those times. But it does not in any way reflected that it could not be determined in terms of money. In view of the difficulties of finding enough cash money for such payments, the Holy Prophet seemed to have considered it convenient for the people to pay Zakat in kind instead of cash. Besides, the calculation of Zakat in kind

1. Dr. Yusuf-ud-Din, op. cit., p. 674-675.
2. S. A. Siddiqui, op. cit., p. 54

was very simple which could be easily understood even by the nomadic Bedouins. Furthermore, it saved a good deal of time which would have been wasted in fixing the value of animals in money. Therefore, the Holy Prophet, in order to avoid the inconveniences of determining the value of cattle and finding cash for payment, ordered that the calculation and collection of Zakat should be made in kind. It was a temporary method which was adopted by the Holy Prophet and followed by his companions according to the needs and convenience of the time. It was extremely simple and very convenient at that time when money was comparatively rare.

In view of the needs of modern times, if we change the method of calculation and payment of Zakat, we will not be doing anything contrary to the decision of the Holy Prophet. The rates of Zakat in kind, as determined by the Holy Prophet, will remain unchanged ; we will only convert them into money rates to suit the needs of our time. Thus it will be possible for us to make the necessary adjustments in Zakat levy to meet our requirements without altering the rates of Zakat.

(b) Invisible Wealth

Invisible wealth consists of all such wealth which it is possible to hide from the authorities, e.g. gold, silver, commercial goods etc.

(i) Gold and Silver

Gold and silver or ornaments of these metals are subject to Zakat by reason of their commercial value just as صوائم are subject to this levy by reason of their physical identity.[1]

Zakat is levied on these metals because they are capable of further production. And the owner of such wealth has to pay Zakat even if he has not used it for this purpose.

It is a stimulus to investment. The capitalist has to pay Zakat at the end of each year even though he has not invested his wealth. If capital is left unused for some time, it will be consumed by the annual Zakat levy. It is, therefore, in the

1. S. A. Siddiqui, op. cit., pp. 42-43.

interest of the capitalist to utilise his accumulated wealth in production and pay Zakat from his profits. As all accumulated wealth is liable to Zakat levy at the end of twelve months, the capitalists are forced by this levy to invest it in trade, industry and other productive openings.

It may, however, be pointed out that Zakat is not levied on income, as in income-tax, but on capital that remains lying with the owner for full one year. Therefore, it will be levied on all accumulated wealth including excess of annual earnings over expenditure, which has not been invested in trade or industry and has remained with the owner for complete one year. At the end of the year all this wealth will be subject to Zakat.

For purpose of Zakat levy, invisible wealth is classified as follows :

(a) Gold ;
(b) Silver ;
(c) Gold and Silver ornaments ; and
(d) Commercial goods.

(a) Gold

The Holy Prophet is reported to have said, "Zakat is 1/40th in gold and silver". There is no Zakat on less than 7½ tolas but on 7½ tolas and above, Zakat will be levied at the rate of 2½% (1/40th) of the value of gold. Minimum exemption limit (Nisab) in gold ornaments is twenty Mithqals (or 7½ tolas), which is calculated from the following Hadith of the Holy Prophet :

"There is no Zakat on gold until its value amounts to 200 dirhams".[1]

(b) Silver

Both in gold and silver Zakat is 1/40th of the value of the metal. The Holy Prophet said that "1/40th is compulsory in silver". According to Ali, the Holy Prophet said, "I remit Zakat on horses for riding and slaves for service ; but pay Zakat on silver, one dirham on every forty dirhams ; and there is no Zakat if there are 190 dirhams, but when the amount

1. S. A. Siddiqui, op. cit., p. 43.

reaches 200 dirhams, there are to be paid out of it 5 dirhams in Zakat". According to this Hadith, there is no Zakat on silver until it reaches 200 dirhams, when 5 dirhams are paid in Zakat. In the opinion of Imam Abu Hanifa, after 200 dirhams, if the additional amount is less than 40 dirhams, there is no Zakat on it ; but when it reaches 40 dirhams, another dirham is paid in Zakat".

According to Abu Saeed, the Holy Prophet said that, "There is no Zakat in less than 5 Auqiyah of Silver". And one Auqiyah is equal to 40 dirhams, therefore there is no Zakat on silver until it reaches the value of 200 dirhams. When 200 dirhams are kept for complete one year, 5 dirhams will be due on them.[1]

In connection with Zakat on gold and silver, the following few points need consideration :-[2]

1. "The Zakat of trade is given preference in case of conflict between Zakat of trade and Zakat of صوائم. Thus if a person has صوائم camels which he has bought for trade, he will pay Zakat of camels as trade articles only. This is based on the argument that as soon as animals are intended for trade, the purpose of pasture and the cause of Zakat of صوائم ceases to exist and they become trade property both in appearance and in reality. It may, however, be added that the right to collect Zakat of animals still belongs to the State, irrespective of whether they are taxed as صوائم or as articles of trade".

2. "For purposes of Zakat, bullion gold and silver are treated like wrought or coined gold and silver, such as dirhams and dinars or ornaments, decorations and plates made of them. Gold and silver wrought for purposes of decoration and personal adornment pay Zakat as bullion whether or not they are used by women or kept for purchase of necessaries, for personal adornment

1. Dr. Yusuf-ud-Din, op. cit., p. 678.
2. S. A. Siddiqui, op. cit., pp. 44-46.

or for trade. Since gold and silver are by nature intended for trade they are considered as productive property and hence pay Zakat".[1]

It may, however, be pointed out that, according to Imam Malik, Shafi'i and even Abu Hanifa, there is no Zakat on lawful gold and silver ornaments of women. Lawful ornaments include jewellery which is commonly used by women for adornment but it does not include dozens of sets of jewellery kept by wealthy people as a mark of distinction. Such unnecessary accumulation of jewellery does not come under the definition of lawful ornaments and is, therefore, subject to Zakat like gold and silver.

3. "In determining whether or not the Nisab is complete and Zakat is due, it is weight and not the value or number that is taken into account. For example, a vase of artistic beauty may be worth many times its value in weight but Zakat will be levied on its weight. In such a case Zakat is levied on weight and not on value. In the matter of payment of Zakat also, it is still weight that serves as basis when Zakat debt is paid in terms of its own genus. If, however, Zakat debt is paid in term of another genus, it is value that is taken into consideration".[1]

4. "If gold or silver be mixed with an alloy, it is considered as pure if the alloy is less than half the contents. If the alloy equals the nobler metal, it does not then pay as gold and silver. Finally, if the alloy is more than 50%, the article is considered to belong to the class of articles of trade if it falls under the latter description or is used as currency. According to one view, however, in gold and silver coins it is necessary actually to separate the precious metal and it is sufficient if it is known that they contain Nisab weight of the metal in question".[1]

5. "If gold is mixed with silver instead of with an alloy and if gold predominates over silver, the entire contents

1. S. A. Siddiqui, op. cit., pp. 44-46.

are taxed as gold. If, on the contrary, silver predominates, then each pays Zakat separately, if of Nisab weight. It may be added in this connection that in the matter of alloy if Zakat-payer does not know the amount of Zakat he must pay, he may either resort to the opinion of two experts or determine it by the method of water displacement (by finding volume of pure gold and alloy and the article by putting them in water separately)".[1]

(c) Gold and Silver Ornaments

In the opinions of Imam Shafi'i and Imam Malik, there is no Zakat on lawful gold and silver ornaments. Imam Abu Hanifa also holds the same opinion. But there is consensus of opinion among all the jurists that Zakat is compulsory on all gold and silver utensils as well as on ornaments of these metals.[2]

According to Sahib Hidaya, there is a compulsory Zakat levy on gold and silver bullion as well as ornaments and utensils of these metals. The argument of this school is that the basis of Zakat is the productivity in gold and silver bullion as well as in their ornaments and utensils. These metals are meant for use in trade (and industry) and possess productivity and Zakat is due on productivity.

The following table shows the rates of Zakat on gold and silver :-

Weight or Value of Gold and Silver	Rate of Zakat
Up to 19 Mithqal or 120 dirhams	No Zakat
20 to 23 Mithqal or 200 to 239 dirhams.	$\frac{1}{2}$ Mithqal of gold or 6 dirhams.
each additional 4 Mithqal or 40 dirhams.	2 Qirats of gold or 1 dirham.

1. S. A. Siddiqui, op. cit., pp. 44-46.
2. Dr. Yusuf-ud-Din, op. cit., pp. 680-681.

(d) Commercial Goods

Commercial goods include all those goods which are neither measured by weight nor volume and are neither animal nor real estate. In fact, all goods, excepting gold and silver, come under the definition of commercial goods because all are likely to become articles of trade and therefore pay Zakat.

The meaning of commercial goods or articles of trade is further clarified by the following extract from Inayah :[1]

1. "What is inherited, even though intended for trade, does not, by unanimous opinion, become an article of trade, because in this case the act is wanting. This becomes clear when it is remembered that in Muhammadan Law, inheritance is compulsory and takes effect without and in spite of the will of the heirs who cannot refuse to be heirs.

2. "What is acquired against a consideration of wealth (مال) e.g. through purchase, location (اجارہ) or loan. Such acquisitions become articles of trade if intended for trade, since there would then be in them both the intention and the act of trade. This is also unanimously agreed upon".

3. "What is acquired for a consideration that is not wealth (مال), such as the prices of marriage (مہر), divorce (خلع), and composition from the right of retaliation for murder (Badal-al-Sulh "an dam al amd)" or what is acquired for no consideration at all, such as gifts, alms and legacies. According to Abu Yusuf, wealth acquired in these ways comes under the description of articles of trade if intended for trade, but it does not so come according to Muhammad Ibn-al-Hasan".

It may, however, be remembered that the intention to trade is essential. There must be intention to trade when the goods are acquired. If there is no intention to trade at the time of the purchase, the goods will be considered to have been bought for

1. S. A. Siddiqui, op. cit., pp. 46-48.

personal use. On the other hand, goods bought for trade will be considered as commercial goods even if a part were used for personal uses. These goods will remain so until they are intended to be used for other than trade purposes.

If the goods are not sold and remain with the trade for one year, they will be subject to Zakat. According to Imam Malik, if any one buys wheat or dates with gold or silver for trade purposes and they remain in his possession unsold for full one year, they will be subject to Zakat, if they fulfil the necessary Nisab limit. All articles of trade, irrespective of their quality or kind, are subject to Zakat provided their value comes up to Nisab either by gold coin or silver coin.[1]

According to Imam Abu Hanifa, the value of commercial goods should be fixed in terms of money which is more advantageous to the poor. In the opinion of Imam Abu Yusuf, value of articles of trade should be reckoned in that money by which they were purchased provided their price was paid in money. This is very helpful in finding out the value of the goods. If the goods are bought in exchange for something other than money (through barter) then the price should be reckoned in money which has greater circulation. Imam Muhammad is of the opinion that the value of articles of trade must be appraised in terms of money which has greater circulation.[2]

Levy of Zakat on articles of trade is very effective in discouraging hoarding of commercial goods in order to increase prices by artificial means.

To sum up, Zakat is a compulsory levy which is collected from the wealthy and spent on the poor and the needy. For this purpose, all types of wealth, including idle wealth, is subject to a levy of 2½%, agricultural produce at the rate of between 5% and 10%, mineral wealth, including gold and silver etc. at 20% of the value (or weight).

1. Dr. Yusuf-ud-Din, op. cit., p. 681.
2 *Ibid.*, p. 682.

Chapter 16

ZAKAT—III

Beneficiaries

The beneficiaries of Zakat are fixed by the following verse of the Holy Quran :

"Sadaqat (Zakat) are only for the poor and the needy, and those employed to administer it and those whose hearts are made to incline (to truth), and (to free) the captives, and those in debt, and in the way of God and for the wayfarer...an ordinance from God". (9 : 60)

[1]"That by Sadaqat here is meant the obligatory charity, called Zakat, and not voluntary alms, is shown by the concluding words of the verse which calls it an ordinance from Allah. The verse defines the objects for which the poor rate may be spent. Altogether eight heads of expenditure are recognised. There are the poor, or those in straitened circumstances ; then there are the needy, by which are meant people who need some help to enable them to earn their living. Poor students and craftsmen or bnsinessmen without sufficient means could be included in this category. Thirdly, there are the collectors of Zakat and other people employed to administer the funds. This shows that the institution was meant for raising a public fund, whose management should entirely be in the hands of a public body. The Holy Quran does not recognise it as a private

1. *Holy Quran*, Translation by Muhammad Ali, p. 399, note 1069.

personal use. On the other hand, goods bought for trade will be considered as commercial goods even if a part were used for personal uses. These goods will remain so until they are intended to be used for other than trade purposes.

If the goods are not sold and remain with the trade for one year, they will be subject to Zakat. According to Imam Malik, if any one buys wheat or dates with gold or silver for trade purposes and they remain in his possession unsold for full one year, they will be subject to Zakat, if they fulfil the necessary Nisab limit. All articles of trade, irrespective of their quality or kind, are subject to Zakat provided their value comes up to Nisab either by gold coin or silver coin.[1]

According to Imam Abu Hanifa, the value of commercial goods should be fixed in terms of money which is more advantageous to the poor. In the opinion of Imam Abu Yusuf, value of articles of trade should be reckoned in that money by which they were purchased provided their price was paid in money. This is very helpful in finding out the value of the goods. If the goods are bought in exchange for something other than money (through barter) then the price should be reckoned in money which has greater circulation. Imam Muhammad is of the opinion that the value of articles of trade must be appraised in terms of money which has greater circulation.[2]

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1. *Holy Quran*, Translation by Muhammad Ali, p. 399, note 1069.

charity. It is sad to note that, as the Holy Quran would have it, the institution of Zakat is entirely neglected by the Muslims. In the fourth class are people whose hearts are made to incline to truth. With respect to the preaching of a religion there is always a class which is ready to listen but the carrying of the message of truth to them needs funds. There are also people who may need help, if they accept the truth. Expenses in this connection are recognised here as a part of the necessary expenditure of Zakat".

"The fifth head relates to the freeing of the prisoners of war and the necessary expenses incurred in that connection. The sixth class is that of debtors—people who incur debts for right purposes, for example, debts of farmers for improving agriculture etc. Islam requires all the members of Society to live in a free atmosphere, and those burdened with debt must therefore, be freed of their burdens. Squanderers of wealth are, however, not included in this category".

"The seventh head is in general words, فى سبيل الله, or in the way of Allah. Some limit the significance of these words to warriors (fighting in defence of faith), or those who are engaged in propagating Islamic truths, while others think that the words are general and include every charitable purpose. The eighth head is that of wayfarers, people who are stranded in a country, to whatever religion or race they may belong".

Thus the beneficiaries of Zakat are enumerated by the Holy Quran and the State has, therefore, no authority (as some 'modern' writers claim) to spend these funds on purposes other than those laid down in the above-mentioned verse of the Holy Quran. These eight heads of expenditure, which are prescribed by the Holy Quran, are dealt with below :

(a) The Poor (فقراء)

The word faqir (فقير) means a destitute and a poor man who has nothing to live on ; or a healthy and honest but unemployed

person who has no source of income. The word faqir (فقير) is used in the latter sense in the story of Moses in Sura 'Al-Qasas in these words :

"So he watered (their sheep) for them, then went back to the shade, and said : My Lord, I stand in need (فقير) of whatever good Thou mayest send to me".

Here the word فقير is used for an unemployed person who has left his country for fear of oppression to seek refuge in another country. Thus the word may equally be used for all the emigrants who are forced to leave their country by political changes (as it happened in India and Palestine after the Second World War).

The Muslims, who emigrated to Madina, to seek refuge from the cruelty and oppression of the Meccans are called faqir (فقير) in Sura 'Al.Hashr' in the following words :

(i) "(It is) for the poor (للفقراء) who fled, who were driven from their homes and their possessions, seeking grace of God and (His) pleasure, and helping God and His Messenger". (59 : 8)

Again in Sura 'Al-Baqarah' :

(ii) "(Charity) is for the poor (فقراء) who are confined in the way of God, they cannot go about in the land ; the ignorant man thinks them to be rich on account of (their) abstaining (from begging). Thou canst recognise them by their mark—they beg not of men importunately". (2 : 273).

[1]"In short, the term includes all poor, old, incapacitated individuals and those who cannot earn a livelihood as well as those who are performing the duties of Islam, e.g. students, teachers and propagators of Islam, who have no time to devote to earning a livelihood, as well as the unemployed".

The reason why they should be given someting for maintenance from the obligatory levy is stated in the words "they had lost everything and had to leave their homes as well as their

1. S. A. Siddiqui, op. cit., p. 158.

property". It is necessary to remember, moreover, that one of the important heads of expenditure in the "Bait al-Mal", was the help of the poor and those who were unable to earn their livelihood. It was under that head that the refugees who had lost all their wealth and homes and were still so poor that they could not carry on any business of their own, were to receive anything from what the Bani Nadir left, all of which formed part of the public treasury".[1]

In view of this necessity, the Holy Quran has reserved a part of the Zakat Fund to meet the requirements of these poor and destitute people or unemployed labourers who cannot find work and are in straitened circumstances. It is, in a way, their nationl insurance which, by helping them during unemployment period, protects them against the tyranny of the employers.

Thus Zakat is a double weapon for the assistance and protection of labourers. It is collected from the rich employers to help poor labourers. As such, it provides some insurance to the labourers to hold on, when unemployed, for a sufficiently long time to enable them to bargain a reasonable wage on equal terms with the employer.

(b) The Needy

The needy like the poor also benefit from the Zakat Fund. The word مسكين covers all those people who are rendered helpless or invalid by sickness, old age or war and are either not able to do any work or can do some work but do not earn enough to maintain themselves and their family. All those people who become blind, lame, invalid etc., in war come within the definition of مسكين. In the opinion of Imam Abu Hanifa, the needy (مسكين) are worse than the poor (فقراء) because they are rendered quite helpless for lack of money.[2]

> "The needy or the indigent are those who do not have anything and who need to resort to begging in order to make a living and obtain enough clothing to

1. Holy Quran, op. cit., p. 1046, note 2478.
2. Dr. Yusuf-ud-Din, op. cit., pp. 728-729.

> hide their nakedness. However, from the practical point of view, the difference in the definitions of "poor" and "needy" is not of much consequonce".[1]

In short the needy (مسكين) are people who possess something but less than Nisab, not enough to meet their needs or who are heavily under debt. Thus the needy are people who possess little but not enough to enable them to live without assistance.

The Holy Quran has laid great emphasis upon the fact that "The Needy" deserve every help, not only from the State as beneficiaries of Zakat Fund, but also from individual charity. For example in Sura Al-Baqarah, the Muslims are enjoined to help them in the following words :

(i) "It is not righteousness that you turn your faces towards the East or West, but righteous is the one who believes in God—and gives away wealth out of love to the orphans and the needy". (2 : 177)

> "The essence of religion of Islam", we are here told is faith in God and benevolence towards men. Helping the orphans and the needy is more important and virtuous in the eyes of God than the performance of mere outward ceremonies".[2]

(ii) Then in the same Sura :

> "They ask thee as to what they should spend. Say : Whatever wealth you spend, it is for the parents—and the orphans and the needy". (2 : 215)

It may here be pointed out that Islam does not provide mere necessaries of life to the poor and the needy but goes much further to enable them to enjoy a reasonable standard of living. Besides it does not discriminate between the poor and the needy belonging to different races and creeds. All those who come under the definition of faqir (فقير) and miskeen(مسكين), irrespective of their colour or creed, receive their share from the Zakat Fund. The Caliph 'Umar interpreted the words of the Holy Quran "Poor" and "Needy" as of general application

1. S. A. Siddiqui, op. cit., p. 159.
2. Holy Quran, op. cit., p. 71, note 213.

and, therefore, included under this head the poor and the needy from amongst the non-Muslims.[1]

When Khalid Bin Waleed made a treaty with the inhabitants of the town of Hira, he included in the terms of the agreement the grant of maintenance to the needy and the invalid non-Muslims out of State treasury.[1]

(c) The Collectors

The third recipients of the Zakat Fund are the collectors appointed by the Head of the State (Imam) to collect and distribute Zakat. The term 'collector' included all the officials, such as, collectors, clerks, scribes. distributors, store-keepers, accountants etc. who might be appointed to assist in the collection, storage, distribution and administration of the Zakat Fund.

The collectors are paid wages out of the Zakat Fund irrespective of their own financial position. It is a salary paid for their work in connection with the Zakat Fund. The salary of each worker will be determined, as in other Government and semi-Government departments, according to the nature and the degree of responsibility of his work.

According to one school of thought the collectors should be paid the price of their labour but the total expenditure should not be more than 5% of the Zakat Fund. According to another school, the total payment to the collectors could go up to ¾ of the Zakat Fund ; while others do not prescribe any upper limit to the payment of the collectors.

Whatever be the price of the collectors, it is the duty of the State to see that the Zakat Fund does not lose its real purpose i.e. helping the poor and the needy. In other words, its expenditure must not be allowed, under any circumstances, to exceed its revenue, otherwise it would become unproductive and would lose all its significance.[2]

(d) Mau-Allafa-tul-quloob (مولفة القلوب)

Under this head could be included various classes of people

1. S.A. Siddiqui, op. cit. p. 159.
2. *Ibid.*, p. 160.

whose friendship and co-operation might help in strengthening Islam. People recently converted to Islam who might have lost their previous property and need encouragement and assistance ; such converts could be given financial assistance simply as an encouragement even if they have not lost any of their property and are neither "poor" nor "needy" ; if the Muslims are not allowed to preach and practice their religion and are tyrannised and oppressed in any land, payments could be made from the Zakat Fund if it could help in removing those restrictions and oppression.

Then the term is wide enough to include the people whose friendship is bought by paymnet out of the Zakat Fund and who are thus deterred from doing any harm to the Muslims or the Muslim State.

Large sums were spent under this head during the time of the Holy Prophet but the amount decreased in the time of the First Caliph, Abu Bakr. But the Second Caliph, 'Umar and other Caliphs after him, stopped this expenditure when Islam gained strength and thus this share out of the Zakat Fund has lapsed since then. But whenever there is need to help either newly converts to Islam in order to provide them with means of livelihood until they are able to stand on their own feet ; or to encourage them in faith ; or to deter the mischiefmakers from disturbing the peace of the land, this use of the Zakat Fund can be revived.

(e) Freeing of Captives (Slaves)

Islam has adopted different methods to remove the curse of slavery from humanity. Among others, a portion of Zakat was spent to win freedom for the salves. According to Imam Abu Hanifa and Imam Shafi'i, slaves should be paid enough money to win their freedom. Imam Malik is of the opinion that slaves should be bought with Zakat money and then set free.

Though this use of Zakat has also lapsed long since, it may be revived (if not repugnant to the intended use mentioned in the Holy Qur'an and the Sunnah) by assisting artisans and handi-craftsmen to set up their own small industries instead of

working as labourers. This will not only help them to be their own masters but will also greatly increase the wealth of the country.

(f) The Debtors

All debtors whose debts exceed their personal belongings (i.e. their ability to pay) are helped out of the Zakat Fund to pay off their debts provided their debts were not incurred for unlawful acts, e.g. indulgence in luxuries, drinking, gambling and speculation etc. For this purpose the debtors are classified into two categories :[1]

1. Those who incurred their debts in satisfying their necessaries of life. If they are not rich and do not possess wealth over the prescribed Nisab, their debts could be paid off out of the Zakat Fund.

2. Those who incurred their debts in assisting other people. The debts of such people, whether rich or poor, will be paid off out of the Zakat Fund.[1]

According to Imam Abu Yusuf, the debtors include all those people who cannot pay off their debts. Sahib Hidaya is of the opinion that it means those who owe bebts and do not possess anything above the prescribed limit of Nisab. Qatada thinks that "غارم are those people who are entangled in the snare of debt and the burden of debt is due neither to their extravagance nor unlawful expenditure nor their poverty". And according to Mujahid "غارم is one whose house burned or whose belongings are washed away by flood and he cannot maintain his family".[1]

The Holy Quran, while describing the beneficiaries of Zakat, mentions غارمين along with "the poor and the needy", which clearly shows that this item of expenditure refers to the wealthy debtors who have been forced by circumstances to take loan because poor debtors are covered by the above-mentioned categories of "the poor" and "the needy".[2]

In all these and similar circumstances, it is the duty of the

1. Dr. Yusuf-ud-Din, op. cit., p. 732.
2. *Ibid.*, pp. 733-34.

head of the State to pay off debts of the debtors out of the Zakat Fund.[1] The Holy Prophet fully accepted the responsibility of paying off debts of the poor debtors or even of the wealthy, who incurred their debts in accidents and were not spendthrift, and maintaining their families on State expense. Thereafter, all the debts were paid off out of the treasury by the Caliphs.[1] The following Hadith of the Holy Prophet supports the above view :

The Holy Prophet is reported to have siad that "Whoever leaves property is for his inheritors and whoever leaves any debt is for us (the State)".

State assistance in paying off debts incurred for productive purposes or for meeting the basic needs of one's family has great significance. It has special significance in under-developed and agricultural countries where the farmers, due to the very nature of this industry, greatly depend upon the natural factors and, are often heavily under debt. Islam enjoins upon the Muslim State to pay off debts of such people and lessen their burden so that they may be able to live and work in peace for their own good and for the good of society in general.

In short, the word "used to help debtors" has very wide scope and is meant to provide assistance to deserving but honest debtors.[2]

(g) Cause of Allah (فى سبيل الله)

This is a very wide term and its practical forms could only be determined by the prevalent conditions and needs of the time. It could cover varieties of acts, such as assistance in the preparation of the Muslims for the Holy war ; provision of medicinal facilities for the sick and wounded ; education of those who could not pay for their own education. In short, it covers all those acts which are essential and beneficial to the cause of the Muslims and Islam.[3] The following extract should help in understanding the wide scope of this important head of

1. Dr. Yusuf-ud-Din, p. 732.
2. S. A. Siddiqui, op. cit., pp. 164-165.
3. Sayyid Qutb, *Social Justice in Islam.*

expenditure :

"Certain jurists have taken the words "the way of God', to mean the religious war. The limitation does not appear to be correct. In the preceding Quranic verse (Alms are for the poor, who are straitened for the cause of Allah), the phrase 'the cause of Allah' does not mean religious wars only but every act of piety and every religious act".[1]

It could mean pilgrims, who, because of their poverty, could not complete their pilgrimage to the Holy place. It could also mean poor students as well as poor people who are committing the Holy Quran to memory. Thus it could be taken to include all those people who are serving the cause of Islam in multifarious ways throughout the Muslim State provided they are not already receiving financial aid from the treasury. According to Imam Baidavi, "the cause of Allah" may also cover the expenses of building bridges and castles for the benefit of poor people.[2]

(h) The Wayfarers

A person, who becomes destitute but cannot benefit from his wealth being away from home on a journey, is called a wayfarer. He needs financial help to complete his journey. He will be helped upto his requirements on the journey out of the Zakat Fund provided his journey was not undertaken merely for pleasure or for any unlawful purpose.[3]

According to Imam Abu Hanifa, a wayfarer who is in the middle of the journey will be given help but not one who is at the start of his journey. But the words used in the text are of very wide application and any wayfarer who is at the start of his journey can be given financial aid provided his claim is genuine and reasonable.

Even emigrants, who have to leave their homes and all their belongings, owing to political oppression, war and racial and

1. S. A. Siddiqui, op. cit., pp. 164-165.
2. Dr. Yusuf-ud-Din, op. cit., p, 738.
3. Sayyed Qutb, *Social Justice in Islam.*

religious hatred and persecution, could be included in the definition of a wayfarer.

The wayfarers can be helped by cash as well as by providing other conveniences and facilities to them in the form of rest-houses, waiting rooms, baths etc., at the stations and other convenient places throughout the country. Even construction of new and repairing of old roads and bridges can come under this head.

In fact, all that facilitates easy and comfortable journey in the country and encourages traffic could come under this head.[1]

Conclusion

These eight heads of expenditure have very wide scope, and cover almost all forms of social security (social insurance) in the community. But it may be remembered that these beneficiaries have a claim on Zakat only if they tried their utmost to earn a living and have failed to earn enough to maintain themselves and their families. Thus Islam, on the one hand, encourages people to work hard and earn their own livelihood and on the other, enjoins upon the Muslim State to provide work to every member of the State. In this way, with individual efforts and State help every member of the community should be able to earn his livelihood in a Muslim State.

But in spite of all this, if some person or persons are still unable to earn their livelihood or earn something but not enough to maintain their families, Zakat helps in their straitened circumstances. It is thus a last resort for those who, in spite of their best efforts have not been able to earn their living or do not have enough to meet their needs.[2]

The comprehensiveness of the National Social Security Scheme thus covers all in the Islamic State.

1. S. A. Siddiqui, op. cit., p. 195.
2. Sayyed Qutb *Social Justice in Islam.*

Chapter 17

ZAKAT—IV

Procedure of Distribution

After explaining the various beneficiaries of the Zakat Fund, we will now deal with the procedure of distribution of this Fund in the following pages :

1. There is difference of opinion among the jurists as to whether the fund should be divided equally into eight shares or should be disbursed to all classes together. We need not go into details of this distribution because the Head of the State has authority to determine the amount of these shares in accordance with the circumstances and requirements of the time.[1]

2. The second question is how much must we pay to each beneficiary. Obviously, the purpose of the Zakat Fund is to help people out of their financial troubles and not to make them dependent upon it. It is, therefore, reasonable to pay them enough to get over the period of stress. The debtors should be paid an amount large enough to pay off their debts and leave something to meet their own needs.

In the opinion of the jurists the maximum amount of money that can be paid to any one beneficiary, after meeting his debts, etc. at one time should not exceed the limit of Nisab, i.e. 200 dirhams.[1]

3. Then it is said that the payment of Zakat must result in the transfer of ownership to the recipient of the thing given. Further, payment of Zakat should not result in direct or indirect benefit to the giver (of Zakat).

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1. S. A. Siddiqui, op. cit., pp. 167-168.

In view of this, it seems unlawful to give Zakat to one's direct descendants or ancestors or even to one's spouse because in these cases there will not be complete transfer of ownership of the given share to the recipient.[1]

4. It is an obligatory duty of the Muslim State to guarantee the maintenance of all its members, Muslims as well as non-Muslims. All poor and needy in the community must be provided with sustenance from the Zakat Fund irrespective of race, colour or creed. It is a statutory duty upon the Muslim State and any discrimination between the recipients because of race, colour or creed will render the authorities negligent and answerable to the court of law and, above all, sinful in the eyes of God for which they shall be answerable on the Day of Judgement.

5. Furthermore, nothing should be given to the family of the Holy Prophet out of the Zakat Fund. This view is supported by the Hadith of the Holy Prophet and there is complete agreement among the jurists on this point.

Objections

Some people, without understanding the meaning and the real significance of Zakat, have raised objections against its levy. It shows not only that they do not understand the nature of this levy but also that they are ignorant of the rudimentary principles of investment.

The first objection against Zakat is that it will discourage trade, industry and other business enterprises in the country. This objection is in fact raised by those people who do neither understand the spirit of Zakat nor its effect on the rate and volume of investment. Zakat is criticised as they would criticise any other tax levied by the Government for raising revenue. But it is not a tax in the ordinary sense, as explained earlier, but is an act of worship like daily prayer and the spirit working behind it is quite different from that of an ordinary tax. The Muslims voluntarily pay Zakat and feel happy and satisfied having performed their duty just like prayer.

1. S. A. Siddiqui, op. cit., p. 169.

It is something that concerns your conscience. If you believe in God and the Day of Judgement and regard prayer and Zakat as obligatory duties laid upon you by God, you will then perform these duties willingly and will be glad to have paid more than the prescribed share. Such people do not count their time and wealth which are spent in the name of God. They seek His pleasure by giving not only $2\frac{1}{2}\%$ of their wealth but as much as they can spare after meeting their basic requirements. After doing their duties, they do not feel proud but show their humility by thinking God for providing them the opportunity to pay back their debt which they owed to the poor members of the community. They are fully conscious of their duty to the poor members of the community as described in the following verse of the Holy Quran :

> "And in their wealth is the right of him
> who asks, and him who is needy" (51 : 19).

It must be borne in mind that this levy will not be added to the price of commercial goods in order to transfer its burden on to other people as it happens in modern sales tax. This is because Zakat is not calculated as an item of expenditure by the Muslims but is taken out of their net profits at the end of the year and is paid to the treasury from their personal income and not from the gross earnings as some people might think.

Let us assume for a moment that Zakat discourages trade and industry. People for fear of this levy do not like to invest their capital in commercial and industrial enterprises. But if they do not invest their capital, where will they take it ? Will they hoard it or spend it ? If they hoard their capital in any form, they still have to pay Zakat out of their total wealth at the end of the year for Zakat is levied on all forms of wealth by reason of their productivity. Whether it is used productively or left in the form of hoarded wealth. Zakat is to be paid out of total wealth at the end of the year. Since all cash, gold or silver or currency are by nature intended for use in trade and industry, they are considered productive and hence liable to Zakat levy. Thus Zakat never leaves capital alone but follows it constantly

whether invested or hoarded and thereby forces its owner to use it productively.

When a person has to pay Zakat on his hoarded wealth every year, he will prefer to invest it in order to be able to pay Zakat as well as some of his own expenses out of his profits.

If he does not invest his wealth for some time, Zakat levy will slowly but surely finish his wealth. He will, therefore, be wise enough to invest his capital in some productive enterprises, in order to pay Zakat from his profits and at the same time increase his wealth. Zakat thus provides a very strong stimulus to the wealthy people in the community to invest their capital rather than leave it unused and let it be finished in due course by the regular payments of the annual Zakat levy.

In fact there are two powerful factors behind the levy of Zakat which encourage the investment of capital in industrial and commercial enterprises. Firstly, there is the psychological factor : the very fact that Zakat is paid to seek the pleasure of God is enough to encourage people to use their capital as far as possible for productive purposes so that they may earn more wealth and pay more Zakat, thereby earning still greater pleasure of God. This factor permeats the whole fabric of Muslim society and supplies sufficient capital to keep the wheels of trade and industry continuously running.

Secondly, there is the economic motive : the more you invest your capital in trade and industry, the greater profit you make. The people are thus encouraged to invest their capital rather than to hoard it. If the institution of Zakat is revived in its true form, and every form of hoarded wealth is subject to Zakat, all hidden (unproductive) wealth will be invested in productive enterprises. Every owner of such property will endeavour to use his wealth in the best possible way in order to make higher profits. As Zakat is to be paid under all circumstances, everyone would prefer to pay it out of profits than to pay it out of stationary hoarded wealth. This realisation on the part of the owners of hoarded wealth would make available to trade and industry a large amount of capital which, otherwise, would have been lying unused with them.

Some other authors have objected to the Zakat levy on the ground that, as it is levied on savings, everyone will try to squander his wealth before the year is out. But this objection is also based on the fallacy that Zakat is a tax and that the people are compelled to pay it by force by the Government. Besides, it is not always levied on savings at the end of the year. This applies only to cash, or gold and silver. In case of agricultural produce, it is collected on the spot. This objection does not apply even to commercial and industrial goods for the owner of these goods is not such a fool as to squander all his profit and capital merely to avoid the payment of Zakat. Even if he is such a fool, where will he squander his wealth ? Will he spend it all on drinking, gambling, speculation, luxuries etc., but they are all unlawful in a Muslim society. All unproductive and luxurious enterprises, on which wealth can be wasted, are declared unlawful. To check unnecessary and lavish expenditure on luxuries and other articles of pleasure, the State is empowered to introduce legislation to check or stop production and import of such articles.

If anyone would like to spend all or a part of his savings or capital on the building of houses, furniture etc., in order to evade the Zakat levy, his capital would come into circulation in one form or another. It would certainly increase the demand for the products of some industries and would, thereby assist in providing employment to many people in the country. Spending is thus definitely better than hoarding for it helps in bringing wealth into circulation. And one of the objectives of the Zakat levy is to encourage people to spend and invest their wealth in productive enterprises.

The Zakat helps to encourage investment and discourage hoarding of wealth ; it stimulates expenditure on consumption goods both by the owners of wealth and the recipients of the Zakat Fund. The flow of capital to both these channels, i.e. investment and expenditure, will create opportunities of employment for millions of people and, at the same time, lead to rapid growth of the national income of the country.

The double objective of Zakat, i.e. encouraging investment and stimulating spending, is of immense economic significance. Availability of funds for investment stimulates industrial development and quickens the pace of economic growth; while increase in aggregate consumption creates effective demand for the products of many industries in the country. And both the factors, working at one and the same time, help to increase employment in the country. The fact that a rise in the propensity to consume and the level of new investment is necessary for full employment and thereby for economic progress is described by Keynes in these words:

> "The propensity to consume and the rate of new investment determine between them the volume of employment. If the propensity to consume and the rate of new investment result in a deficient effective demand, the actual level of employment will fall short of the supply of labour potentially available at the existing real wage........".
>
> "This analysis supplies us with an explanation of the paradox of poverty in the midst of plenty. For the mere existing of an insufficiency of effective demand may, and often will, bring the increase of employment to a standstill before a level of full employment has been reached. The insufficiency of effective demand will inhibit the process of production in spite of the fact that the marginal product of labour still exceeds in value to marginal disutility of employment".[1]

Thus the continuance of effective demand and new investment are essential for the maintenance of a fair rate of production and, consequently, employment in the country. If there is insufficient demand and a decrease in the rate of new investment, the process of production and, hence, employment will be adversely affected. This state of affairs is more likely to prevail in a wealthy and fully industrialised community where fresh opportunities for investment are rare. In the words of Keynes:

1. *General Theory*, op. cit., p. 31.

> "Moreover the richer the community, the wider will tend to be the gap between its actual and its potential production; and therefore the obvious and outrageous the defects of the economic system. For a poor community will be prone to consume by far the greater part of its output, so that a very modest measure of investment will be sufficient to provide full employment; whereas a wealthy community will have to discover much ampler opportunities for investment if the saving propensities of its wealthier members are to be compatible with the employment of its poorer members. If in a potentially wealthy community the inducement to invest is weak, then, in spite of its potential wealth, the working of the principle of effective demand will compel it to reduce its actual output, until, in spite of its potential wealth, it has become so poor that its surplus over consumption is sufficiently diminished to correspond to the weakness of the inducement to invest".[1]

The Zakat levy is a strong cure for the ills of any community, poor as well as rich. It is a very effective method to increase the aggregate demand as well as the inducement to invest. It provides a powerful incentive both to investment and expenditure in such a way that the two variables move upwards almost in parallel lines. Thus a judicious and careful disbursement of Zakat Fund will always enable a balanced growth of econmy without any fear of either diminution in effective demand or fall in the level of employment.

Furthermore, it is the Zakat Fund which enables a Muslim community to mobilise all its unused and hoarded capital for productive purposes. Even a poor and backward country, according to Western standards, would collect enormous funds for its internal development and would carry out successfully its schemes of industrial and economic planning without foreign assistance or interest-bearing loans. It is a pity that the Muslims

1. *General Theory*, op. cit., p. 31.

have completely forgotten the significance and effectiveness of Zakat as a State institution in mobilishing the resources of the community and are now begging at the doors of the Western Powers for economic aid. There is no doubt that if the institution of Zakat, as prescribed by the Holy Quran and practised by the Holy Prophet and his companions, is revived, many of the economic evils and deficiencies of capitalism experienced by the Muslim countries can be easily overcome within a short period of time.

Another objective of the Zakat Fund is to narrow down the vast difference in income between the rich and the poor as stated in the following verse of the Holy Quran :

> "And in their wealth is the right (due share) of him who asks, and him who is needy" (**51** : 19).

The word used is حق which means incumbent upon anyone ; to contest with anyone for a right ; and duty which one must do ; to overcome anyone in contending for a right. It is thus a share of the poor in the wealth of the rich in which there is no doubt. In other words, it is a rightful claim of the poor upon the rich which they must pay back. If they do not pay back the due share of the poor out of their wealth, they shall be answerable on the Day of Judgement for this injustice. If the rich pay back the prescribed share, the poor should be quite content to receive their own share without claiming more.

The words of the Holy Quran that "in the wealth of the rich there is a definite share of the poor" are very significant. This shows that if this share is paid back to the owner (poor), he must be satisfied and content. The words of the Holy Quran clearly suggest that there is a definite correlation between the prescribed share out of the rich and the needs of the poor in each community. This is further supported by the following Hadith of the Holy Prophet :

> "Zakat is an income which is taken from the rich and returned to the poor".

The word فقراء means to restore anything to a former state ; to give back anything to any one ; to return something to the owner. "Returned to the poor" clearly shows that it was something which belonged to them but was kept in the custody of the rich and has now been returned to them.

In the light of the above verse of the Holy Quran and the Hadith of the Holy Prophet, there seems to be no doubt that the Zakat levy is "a right of the poor in the wealth of the rich" members of the community. The State collects this share out of their wealth and pays it back to the poor and the needy in the community.

Furthermore, the words of the Holy Quran suggest that the total wealth collected from the rich at the prescribed rate should be sufficient to meet the needs of the poor members of the community. When the share of the poor due from the wealth of the rich is paid back, it should automatically improve the financial condition of the former to such an extent that they would no longer be considered poor. In other words, the amount of the levy collected from the rich should be sufficient to raise the standard of living of the poor members of the community.

A critical survey of the haves and the have-nots of a community, at any state of its economic development, is likely to show that the proportion of the surplus wealth collected from the wealthy amongst them is always equal to the proportion of needs of the poor amongst them. If wealth taken from the rich is spent judiciously in providing means of livelihood to the poor members of the same community, it should be enough to raise their standard of living in a few years. In fact, the vast differences in the incomes between the wealthy and the poor that exist at present in the Muslim communities can be brought down to a reasonable and equitable level with the revival of the institution of Zakat. The annual flow of the surplus wealth of the rich at the prescribed rate and its rational distribution is likely to help in bridging this wide gulf between the two sections of the community.

It may here be pointed out that the method of distribution of the Zakat Fund is very important. Mere giving away cash to the poor and the needy will not solve the huge problem : it will in fact permanently create a class of dependants and idlers who would never like to do any work. Therefore the method of dis-

tribution of the Zakat Fund needs careful consideration.

If we study the usual practice of the Holy Prophet in such matters, we find that he often discouraged giving away of cash to the poor. He encouraged people to provide means of livelihood to the poor instead of financial aid. He even disliked and often discouraged begging and "persuaded beggars to try to earn their living." It is stated in the Sahih of Bukhari that a man came to the Holy Prophet asking for charity. The Prophet asked him if he possessed any article and the man replied that he had only a cap. He was asked to bring it. The Prophet auctioned his cap for two or three dirhams with which the blade of an axe was purchased. The Prophet himself fixed a handle to it and told the man to go and cut wood to sell as fuel. He was asked to report his condition after a few days which he did. The man reported with joy that he was satisfying all his needs and also saving something. The Prophet desired all men to be workers—the rich as well as the poor".[1]

If the Zakat Fund is utilised in providing means of livelihood to the poor and the needy according to their professional skill, individual aptitude and the varying needs of different geographical units, the existing poverty and the unjust distribution of wealth in the Muslim countries, could be removed.

Statistical Formula

There seems to be, as explained in the previous section, an intimate relationship between the aggregate wealth collected from the rich in the form of Zakat and the needs of the poor in the community. This relationship between the two variables is not only real and measurable in statistical figures but is universal and is to be found in every community whether underdeveloped, or fully developed, agricultural or industrial.

The two variables seem to be controlled and maintained in the right proportion by some hidden law of Nature so that the real purpose of the Zakat levy is never lost if properly applied and administered by the authorities.

1. *Islam and Communism*, op. cit., p. 191.

A Hindu writer[1] has very ably shown the correlation between that portion of the community which does not earn sufficiently and that which earns sufficiently to pay Zakat and still enjoy level of comforts. He examines the institution of Zakat to find out "whether it was fixed empirically and arbitrarily ; or whether it had some basis of justification in the economic structure in the early Islamic communities.

He argues that "In every normal community, which is not in the grip of actual famine, or in the midst of a big war, the number of persons who earn snfficient to make the two ends meet (which we shall call the subsistence-mark) must exceed those who do not so earn. Let us as a first approximation, and as an extreme case, suppose the two numbers to be equal to each other. Among those who earn sufficiently, the Pareto Law of Distribution of Incomes will hold good. But the Pareto Law cannot be expected to apply to those whose earning is below the subsistence-mark. Let us suppose that among this class the distribution of incomes is linear, and that it varies from subsistance-mark to half of it ; for to suppose that a given large portion of the community is permanently below the semi-starvation limit is to suppose permanent famine conditions".

Then he presents the problem diagrammatically and explains it by means of an equation and argues that a part of the total want of that portion of the community which does not earn sufficiently is supplied by themselves and the balance is made up by the aggregate of Zakat received from all persons whose income is above the lower limit of Zakat. Thus the average of all incomes above the subsistence-mark is adequate to meet the total need of that portion of the community, which does not earn sufficiently. "In other words, the Zakat realised is sufficient to meet the wants of the poorer portion of the community".

And finally he concludes that "there is thus correspondence between the two sides to the extent that 17.75 $ equates to 19.56 $. The error, or the difference between the two sides is some 9°/₀.

1. J. M. Datta, Zakat—The Economic Basis of Islamic Tithe, *The Economic Journal*, June, 1939.

Allowing for the cost of collection, and something for evasion—both wilful and unconscious—there is sufficiently close correspondence between the two sides of the equation to warrant us to think that the amount of Zakat was not fixed arbitrarily, but was based on observation of the economic structure of the then Islamic society and its wants".

Our presumption is that this close correspondence between the two sides of the equation (i.e., the poorer portion and that which earns sufficiently above the lower limit of Zakat) is constant and permanent irrespective of the structure or stage of development of a community.

Pareto's Law and his Assumptions

The problem discussed above is based on Pareto's Law which rests on certain assumptions. Our argument is that the equation presented by the above writer can be proved to be much more accurate and true for all societies and for all times more accurate and true for all societies and for all times if the assumptions are modified and made more realistic and closer to truth. Pareto regards increase in production as the only way to increase income welfare because of the rigidity of the distribution of incomes. He argues that :[1] "Owing to the rigidity of the distribution of incomes there is only one way to increase income welfare, and that is by increasing production. There is no possibility of increasing the share of the poorer classes in the national income except in this way. In Pareto's Law welfare must grow more rapidly than population if a country's minimum income is to be raised or the inequality of income diminished. The problem of improving the condition of the poorer classes is before everything else a problem of the production of wealth. The converse proposition is also held to be true. We may say generally that the increase of wealth relatively to population will produce either an increase in the minimum, or a diminution in the inequality of incomes ; or both these effects in combination. In short, the income of the poorer classes in a country cannot be increased

1. Pareto's Law by Foxwell Marshall, *Economic Journal*, 1935.

unless there is simultaneous increase in the incomes among all classes of the population".

Even if, for the sake of argument, we agree with the hypothesis presented in Pareto's Law, the conclusions drawn are not true. The problem of improving the condition of the poorer classes is not merely a problem of the production of wealth as assumed in Pareto's Law. It is as much, if not more, a problem of distribution as of production of wealth. Even if there is increase in the production of wealth, the incomes, and hence welfare, of the poorer classes would not increase if all, or a greater portion, of the increase in income goes into the coffers of a few capitalist. It is therefore absolutely essential that there should be a proper and just distribution of the income among all the sections of the community in order that the poorer classes might benefit equally from the increase in production.

Besides, there is no other effective way to achieve simultaneous increase in the income among all classes of the population except through just and equitable distribution of incomes.

Moreover, the problem of rigidity of distribution of incomes as feared in Pareto's Law, is non-existent in a Muslim community. Income welfare can be increased very easily through the institution of Zakat for it not only helps increasing the income (or welfare) of the poorer classes of the community, but it also stimulates investment and thereby production. Thus the institution of Zakat serves two functions simultaneously. It increases the minimum income of the people in the lower income group and at the same time it reduces the inequalities of income in the community. Further, it would have accumulative effect on the income welfare of the poorer members of the community when revived in conjunction with the other four basic pillars of the economic system of Islam.

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Chapter 18

ZAKAT—V

Hoarding and Zakat

The Zakat levy is a very effective instrument to end completely the amount of idle or hoarded wealth in a Muslim community. The fact that it is levied on the total wealth, invested or hoarded, is a sufficient stimulus to the capitalists to invest their hoarded wealth in order to pay Zakat from the profits and not from their cash balances. Revival of the institution of Zakat will tend to bring out the hidden treasures from the hoards and will thereby enable a Muslim community to mobilise its entire resources for productive purposes. A good deal has been written on this topic and it would not be without interest to study some of the opinions of the Muslim writers.[1]

"Apart from the realisation of social justice, Zakat makes special contribution which has absolutely no parallel in any other economic system, past or present. Zakat is the uncompromising enemy of hoarding. Hoarded wealth is the first item on which Zakat is assessed. Indeed, no secular system can possibly tackle the problem of hoarding with the effectiveness with which Islam can do, because hoarded wealth can only be taxed with the co-operation of the hoarders. And there is no reason why the hoarders should co-operate with the taxing authority against their own dear wealth. In Islam, on the other hand, the fear of God and the fear of the Day of Judgement are enough to force co-operation upon the hoarders against their wealth. It would be almost impossible for a Mussalman not to unearth his

1. *Islam and Communism*, op. cit., pp. 89-92.

hoarded wealth after reading this verse of the Holy Quran (9 : 34) :

> "And there are those who bury gold and silver and spend it not in the way of God ; announce unto them a most grievous penalty—on the Day when heat will be produced out of that (wealth) in the fire of Hell, and with it will be branded their foreheads, their flanks and their backs.—This is the (treasure) which ye buried for yourselves ; taste ye then, the (treasure) ye buried".
>
> "Hoarding here includes not only gold and silver when they are buried in the earth, but all wealth which is kept lying unused".

"According to Islam, wealth should be used to perform two functions only, viz. it should either be spent on good things of life or invested in commerce and industry. To these two channels, Mussalmans are repeatedly enjoined to direct their wealth. Mark the contrast from the ascetic religions of the world :

1. "O ye people ! Eat of what is on earth lawful and good ; and do not follow the footsteps of the evil one for he is to you an avowed enemy". (2 : 34).

Again :

2. "O ye who believe ! Eat of the good things that We have provided for you, and be grateful to God if it is Him ye worship". (2 : 172)

"Earning of wealth (which cannot generally be done without investment) is considered so important in Islam that the Quran permits trade even in the course of pilgrimage :

3. "It is no crime in you if you seek of the bounty of your Lord (during pilgrimage)". (2 : 198)

And again :

"And when the prayer is finished, then disperse ye throughout the land and seek of the bounty of God". (62 : 10)

"The special significance of Zakat is that it is the avowed enemy of hoarding (idle wealth). Islam suggests two alternative channels to which surplus wealth should

be directed. Either spend that wealth or invest it in trade or industry. What happens when people spend money on good things of life? The demand for all kinds of consumption goods increases, and the industrialists and producers find an opportunity to extend their production. Trade becomes brisk and employment is extended. The result is that the nation becomes more prosperous. What happens when wealth is invested in industry and commerce ? Employment increases and more of good things of life are produced. They even become cheaper enabling more men to purchase them. More human needs are satisfied and more men are employed. Again, the result is prosperity and welfare of the nation".

"Hoarding, however, has the opposite effect. To the extent that wealth is hoarded, it sets a limit to the extension of production ; therefore to the extension of employment ; therefore to the extension of national welfare and prosperity. In the economic domain, hoarders are the greatest criminals. No wonder, the Quran has announced, "unto them a most grievous penalty".[1]

Forms of Disbursement

The method of distributing Zakat Fund among the various beneficiaries is very important and could have far reaching effects. The purpose of this levy, as we know, is to help the poor and the needy members of the community so that their economic needs are adequately satisfied. It is, therefore, necessary that financial aid should be given in such a way which satisfies their needs but does not make them idle or permanently dependant upon it. There is, however, no harm in providing individual assistance to persons who have become invalids due to accident or too old to work or have some bodily defect and are unable to work or old widows who have no source of income and cannot re-marry.

But the best way to help even in these cases is to establish

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But the best way to help even in these cases is to establish

1. *Islam and Communism*, op. cit., pp. 89-92.

national institutions and social welfare Centres with the Zakat Fund. Poor houses and orphanages should be built to help the poor and the orphans. New and better houses should be provided to the poor who are living in slums in the towns. Educational institutions with boarding houses should be established for the education and training of the blind, deaf and other defective and handicapped people. Free hospitals should be opened with the Zakat Fund for the treatment of sick persons who cannot afford to pay for medicines and doctors. Unemployed persons could also be given temporary financial assistance from the Zakat Fund. Poor farmers should be given seeds, manures and agricultural implements at the proper time. Their genuine debts incurred in buying seeds, implements, cattle or for making improvement in land should also be paid from the Zakat Fund.[1]

Another important use of the Zakat Fund is the provision of technical equipment and machinery to the artisans, craftsmen and other workers who are able and willing to set up their own small-scale industries in the villages and towns. In the villages it will provide subsidiary occupations to millions of agricultural workers who have plenty of spare time throughout the year. It will enable them to earn extra income which will be a great help to the poor farmers. Thus the establishment of thousands of small-scale and cottage industries in the towns and villages every year will help in reducing the poverty of the people in poorer countries.

The Zakat Fund could also be used in establishing educational and research institutions for research work and teaching of the Quran and the Sunnah in the light of our present requirements. This is absolutely necessary in view of the great challenge of both Communism and Western Capitalism. The Muslims should be fully prepared to meet this challenge on two fronts. And this could only be possible if the Muslims have thorough knowledge of the funadmental concepts of Islam and proper understanding of the modern requirements in order to solve their economic, social and political problems in the light of

1. *Lessons in Islam*, Book III, pp. 20-21.

the Holy Quran and the Sunnah. This is very important for the preservation and propagation of Islam within and without the Muslim world.

It is therefore absolutely necessary to spend a considerable portion of the Zakat Fund on Islamic research and Islamic Studies. "New universities should be built up on Islamic lines, new research Centres and institutes of Islamic Studies should be set up, where a scientific study of Islam is carried on".[1] Pamphlets, journals, books, posters, etc., explaining the fundamental doctrines of Islam, should be published and freely distributed among Muslims as well as non-Muslims. It is not only non-Muslims but even millions of Muslims, who do not understand the main principles of Islam. Problems like interest, insurance, Zakat etc., are baffling to the common man and many of the educated young men have begun to say that interest of the modern banks does not come within the definition of Riba. Some have gone so far as to say that interest is necessary in modern societies and that no country can make progress without modern banking system.

It is our duty to defend the basic concepts of Islam from the internal as well as external attacks and explain them in their true perspective. For this purpose it is necessary to establish research institutes for Islamic studies and train scholars who are able to meet the challenge of the Communists and the capitalists from within and without. The Zakat Fund can be utilised for setting up such institutions.

Zakat and Canons of Taxation

Our contention is that Zakat is not a tax but a religious duty which is considered in importance second only to prayer, and therefore it should not be judged according to the canons of taxation. The nature and purpose are entirely different from that of an ordinary tax and hence it would be grave error to criticise it on the same grounds as we criticise modern taxes, if they do not satisfy any of the principles of taxation. In spite

1. *Lessons in Islam*, p. 25.

of this basic difference between Zakat and an ordinary tax, it would not be without interest to study Zakat in the light of Adam Smith's four canons of taxation. Adam Smith laid down four principles of taxation which are still considered to be the basis of a good tax. These are Equality, Certainty, Convenience and Economy.

(a) Equality

According to the canon of equality every member of the State must contribute toward the public finance in proportion to his respective ability; that is, in proportion to his income. But a proportionate tax does not achieve equality of sacrifice because both the rich and the poor contribute at the same rate and, consequently, it imposes heavier burden on the poor in comparison with the rich. In order to secure a fair apportionment of the burden of the tax richer members of the State should be made to pay higher rates of taxes than poorer members. In other words, a progressive tax, under which the rate of tax increases as the income increases, is likely to secure equality of sacrifice from all members of the State, whether rich or poor.

But this principle is applicable only to modern system of taxation under which a tax is levied upon income and where a progressive tax is the only method of securing equality of sacrifice. As for Zakat, it is levied not on income but on the total annual savings and, as such, a uniform rate of levy ensures equal sacrifice. The poor do not pay any Zakat and the rich pay according to their annual savings. The greater the amount of savings the higher the contribution towards the Zakat Fund and vice-versa. Besides, all this Fund is available for the use of the poor and the needy and the rich do not benefit, directly or indirectly, from it. Thus Zakat fairly satisfies the practical side of the canon of equality.

(b) Certainty

A tax should be certain and not arbitrary. Its time of payment, manner of payment and amount of payment should be clearly known to the tax-payer. The State should also have, as far as possible, a clear estimate of its revenue from the tax. In

this respect, Zakat satisfies all the requirements of certainty because it cannot be altered by any human agency. The time, the manner and the amount of its payment is clearly known to all concerned. It cannot be changed or even modified by any act of the State because of its sanction in the Holy Quran and the Sunnah.

(c) Convenience

A tax should be levied at the time and in the manner in which it is most convenient to the tax payer. In other words, a tax should be levied in such a way and at such a time that the tax payer can easily pay it. Even in this respect Zakat has all the ingredients of convenience. In case of land produce, Zakat is collected at the harvest time, it is collected in kind but can be paid in any other form if the farmer so desires.

In other cases also Zakat is collected at the time and in the manner most convenient to the payer. It is collected in cash as well as in kind, depending on the nature of trade or property and the convenience of the payer of Zakat.

(d) Economy

According to the principle of economy, the cost of collection of a tax should not exceed its income. If its cost of collection exceeds its revenue, it becomes unproductive and uneconomical. It is useless to levy a tax whose income falls short of its cost of collection.

Collection of Zakat does not require a complex and expensive system of organisation. It is a form of : Ibadah (worship) like daily prayer or fasting, and people are anxious to absolve themselves of this duty as soon as possible. They do not need any external pressure of law to persuade them to pay Zakat, and there are rarely any evasion, or delay in its payment. The people pay it voluntarily for the pleasure of God unlike ordinary taxes. Therefore, the cost of collection of Zakat is minimam.

Chapter 19

OUTLINES OF AN ISLAMIC BANK

1. Banking is an integral part of the modern economic system and the whole superstructure of this system is built up on interest. In fact, the modern banking thrives and survives on interest.

2. Famous classical and neo-classical and modern economists agree on one point that the institution of interest is an obstacle in the development of low-profit projects. Interest makes it very difficult, rather impossible, for National and Local Governments, especially in the underdeveloped economies, to take up or initiate new projects of social welfare with very low profit margins but, otherwise, of immeasurable value to the community because they are economically (owing to the contributions of interest) unprofitable.

3. Islam has done a great service to humanity by forbidding this blood-sucking institution which hinders the growth of highly valuable social projects but with low profit margins. It has thus put an end, once for all, injustice and inequity in the economic field.

4. Undoubtedly banking performs some very useful and essential services to the community. It is indispensable for modern society and no economic system can make any progress without its help. It is true to say that no advanced economic system can progress or even maintain its rate of growth in the industrial and technical field in the modern age without the aid of modern banking.

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5. The Muslim world, if it has to exist, politically as an independent body, economically a growing economy, then it must have re-appraisal of the whole situation in the economic field.

(a) There is need for revival of our religious institutions which have long ceased to function properly and have therefore ceased to have purposeful meaning for us.

(b) The growing indifference of our intelligentsia to our institutions and the opinion that they are old and, therefore, not feasible and that some of them are not even in vogue anywhere in the Muslim World is due partly to ignorance and apathy towards Islam and its institutions, and partly to the tremendous influence of the apostatic but growing industrial and technological progress of the Western countries.

(c) This approach is absolutely unrealistic and false. We must study the modern Western System thoroughly and analyse the basic factors which have contributed towards its progress. Then pick up its useful and good things and leave the evils of this system to them.

(d) Modern Banking is one of the factors which helped Western society to attain this growth in the economic field. We are here concerned with this factor.

(e) We can take the organisational, the managerial and the structural side of banking and leave the unsocial profiteering element of this system to them.

(f) Thus we can organise a banking system of our own, based on the principle of no-interest, to perform its proper functions in the modern industrial and technological age.

6. Muslim Banking organisation will be built up on the principle of Shirkat Inan (Free Partnership) and Muzarabat (Limited Partnership) :

(a) One basic problem is to organise our Banking System on these two principles without the element of interest.

(b) Then work out and build up the super-structure of our banking with its essential and useful services indispensable for economic growth in the modern age.

7. Formation of a Muslim Bank :

(a) No bank nor its banking policy can ever successfully operate in any country unless people have trust and full confidence in its creditability. Even the currency notes issued by a central bank of a country and backed by its Government are sometimes refused by the people during times of war.

(b) It is therefore absolutely necessary for the success of an Islamic Bank that the Government of the country in which it is being established should give its full support by declaring

(i) All dealings involving interest as illegal ; and

(ii) All banking based on interest as illegal.

(c) If interest and dealings in interest are not forbidden or even not strictly enforced, then there is every probability that selfish capitalists, and there are always some, will damage social good for their personal gain by continuing in such activities involving interest.

(d) This will obviously encourage black-marketing in banking which is likely to adversely affect the working of interest-free banking.

(e) Besides, there are other factors which must also be taken care of before such a venture can attain real success and balance in the economy :

(i) Social security for the needy and the poor is a must in these circumstances.

(ii) Black-marketing of capital must be discouraged.

(iii) And similar other means helpful to interest-free banking in an Islamic society are needed. Other Islamic laws concerning Zakat, inheritance, Sadakat, etc., must also be enforced to achieve the desired results.

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(iv) Along with these measures, social co-operation of common people—that they are honest, responsible and keen to do social service—will greatly help in the organisation of interest-free banking in the country.

8. Organisation of the Muslim Bank will be based on the following principles :

(a) Capital will be supplied by some persons (or Governments) on the principle of Shirkat Inan (free partnership) and banking business will be organised with this capital on the principle of Muzarabat (limited or silent partnership).

(b) The suppliers of capital will be called share-holders

(i) Details of minimum and maximum number of share-holders and

(ii) Amount of capital to be supplied by each share-holder can be (equal or unequal) can be worked out by the organisers of the bank.

(c) Each share-holder will be the owner of the bank in proportion of his capital to the total capital of the bank.

(d) The banking profit may be divided according to the amount of the number of shares of each share-holder. The total profit will be divided by the total capital of the bank, and each share-holder will be paid on the basis of that profit per unit of capital or per hundred in proportion to his total share-capital or number of shares.

(e) If, in any year, there is loss to the bank, then it will be divided on the same basis as profit in proportion to the share-capital or number of shares of each share-holder.

(f) There will be a partnership contract between the management and the share-holders with regard to the use or investment of capital and the manner in which it is to be used or invested, and other such matters relating to the use or investment of capital.

(g) All problems relating to the business activities of the bank and acquisition of further capital for this purpose through loans etc., will also be settled by the management and the share-holders at the time of the establishment of the bank.

(h) All business activities of the bank relating to the investment of its capital will be organised on the basis of limited or silent partnership (or Muzarabat).

(i) All matters concerning business, banking, or investment will be decided by mutual consultation.

(j) All profits will be divided once or twice (or as may be decided) per year ; and in case of loss, each share-holder will be informed of the amount of loss per unit of capital or per share and the amount will be adjusted either by payment to the bank by the share-holders or by the reduction of the amount of share-capital or number of shares held by each share-holder in proportion to his share of loss.

(k) At the death of any share-holder, his share will pass on to his legal heirs and the business of the bank will not be affected in any way.

(l) Liability of each share-holder will be unlimited and, if the loss to the bank exceeds the total assets of the bank, the excess loss will be paid from the private capital of the share-holders.

(m) In order to provide sufficient safeguards against the probable loss, it would be wiser and in the best interest of the bank, and the community, and the share-holders, to keep a certain percentage of profits in the Reserve fund of the bank, to meet situations of loss, damages and other such unforeseeable emergencies. If there is loss in any year, it will be easily met from the reserve fund without causing any unnecessary distress, or harassment to share-holders. Even though legally the liability of the share-holders is unlimited and they are bound to pay the excess loss

over and above the total assets of the bank, practically the reserve fund accumulated over a number of years will be more than adequate to meet such unforeseeable situations and their liability for all practical purposes will be limited.

(n) Liability of share-holders can be further made limited by reducing the amount of each share. In this case, the amount of each share may be reduced to enable common people to purchase shares of the bank and thus help in the collection of large share-capital from the public.

Functions of the Bank

1. **Accepting Deposits** : The bank will accept deposits from the public on the basis of limited partnership (Muzarabat) and will invest it. Each depositor, being a partner in Muzarabat, will contribute capital and share in the profits according to the percentage agreed with the bank.

The deposits will be of four kinds :

(a) Muzarabat Deposits :

(i) Capital received from these depositors will be invested by the bank and an agreed proportion of the profits on Muzarabat capital (e.g., one third or one-fourth) will be kept by the bank and the rest will be paid to the depositors. The division of profits between the depositors will be made by mutual agreement.

(ii) If the bank has a loss, each depositor will be held responsible for the payment of loss in proportion to his capital.

(iii) No depositor will be held responsible for more than his total capital deposited with the bank. The maximum amount of loss each depositor will have to pay will not exceed the total amount of his deposits in the bank. In other words, liability of these depositors will be limited.

(iv) Muzarabat deposits will be more or less like saving deposits in modern banks with the difference that :

1. The depositors will not be given cheque books and will not be able to draw their money without giving a sufficient notice to the bank.
2. If a depositor withdraws any amount from the bank, he will not be paid any profit for that quarter or half of the year in which he withdraws his capital.
3. No profit will be paid for any deposits withdrawn within three or six months (or any reasonable period fixed for that purpose) from the date of deposit.

(b) Current Deposits :

The bank will invite public to deposit their small savings and incomes for safety and for convenience of making payments etc. These deposits will be treated exactly like current account or demand deposits in modern banks.

(i) The depositor will be given a cheque book and can draw his money whenever he wishes without any limit.

(ii) If the bank suffers any loss on these deposits, it will be borne by the bank. The depositors will not be affected by gain or loss to the bank.

(iii) The bank will have the right to use these deposits for investment purposes.

(iv) These depositors will not be paid any profit on their deposits.

(v) The bank will not ordinarily charge any thing from the depositors, but owing to heavy management, clerical and administrative cost, may charge small amount to cover such costs.

(c) Time Deposits :

The bank may accept deposits for a fixed period of time from the public. These deposits will be treated almost like fixed deposits in modern banks.

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(ii) And the depositors will share the loss, if any, like the Muzarabat depositors.

(iii) The liability of these depositors will be limited to the amount of their total deposit in the bank like Muzarabat depositors.

(d) Loan Deposits :

In order to expand its business, bank can invite loan deposits from the public. Loan depositors will not be paid any profit.

Under all circumstances, the profit or loss, these depositors have to be paid. It is the legal responsibility of share-holders only to pay off the loan depositors.

2. Banking Business : It is true that individual current or other kinds of deposits can be withdrawn by the depositors without limit whenever they wish, but experience of banking over a period of years has shown that actually they do neither withdraw their capital at one and the same time nor do they withdraw their entire capital at once. They draw a small portion of their capital and most of it remains deposited with the bank for most of the time and is not withdrawn at all.

Therefore, the Islamic Bank, like other modern banks, can very easily invest a considerable portion of the deposits and make a profit. It can keep a reasonable percentage of the deposits, according to the banking practice of the country to meet day-to-day demands for cash from the depositors.

Its capital can be used or invested as under :

(a) Free Partnership with its capital :

The bank can invest its capital by entering into partnership (on the basis of Shirkat) with businessmen or firms and share both in capital and business. However, it may or may not actually share in business. The bank would, however, make sure that its liability in case of loss is limited to the amount of its total invested capital in the business.

The profits will be shared between the bank and its partner or partners as fixed in the partnership contract.

(b) Muzarabat (limited partnership) with Capital.

The bank may give its capital to any person or firm on the principle of Muzarabat and share in its profit and loss as mutually agreed. The proportion of profit and loss to be paid to each party will be clearly stated in the contract of Muzarabat.

By the grace of God, Islamic Insurance and interest-free banking will be disussed fully in the 4th volume of this book.

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